EXCLUSION FOR GROUP LEGAL SERVICES PLANS AND MISCELLANEOUS TAX BILLS

HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

ON

H.R. 676, H.R. 2697, H.R. 4114, H.R. 4357, H.R. 5028, and H.R. 5361

APRIL 12, 1984

Serial 98-82

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
37-438 O WASHINGTON : 1984

H781-64

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EXCLUSION FOR GROUP LEGAL SERVICES PLANS AND MISCELLANEOUS TAX BILLS

THURSDAY, APRIL 12, 1984

House of Representatives,
Committee on Ways and Means,
Subcommittee on Select Revenue Measures,
Washington, DC.

The subcommittee met at 10 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Fortney H. (Pete) Stark (chairman of the subcommittee) presiding.

Chairman **Stark**. The Subcommittee on Select Revenue Measures will begin its hearing this morning to consider several miscellaneous bills which cover a wide range of issues.

Among them is the issue of the extension of the provisions providing that amounts contributed by an employer to a qualified group legal services plan are excluded from an employer's gross income and not taxable to the employee.

These provisions will expire at the end of this year.

In addition, the subcommittee will be addressing the issues of mileage deduction for volunteers, debt financed real estate acquisitions by educational organizations, the complex issue of golden parachutes, and problems relating to specific employee stock option plans.

Most of these provisions are currently contained in the Senate Deficit Reduction Act of 1984.

The Chair intends to hold very strictly to a 5-minute rule for oral presentations by the witnesses. I might add, with the exception of the Secretary of the Treasury who must cover all facets of the hearing today in his testimony. The reason for that is that we will be facing other committee hearings and a lot of floor activity today, and in fairness to those witnesses who drew the end slot and to complete the hearings today, I must ask the witnesses to summarize their testimony within the 5-minute period with the assurance that their entire printed testimony will appear in the record.

I would ask that the press releases announcing today's hearing be made a part of the record.

[The press releases announcing the hearing follow:]

[Press release No. 12 of Wednesday, Mar. 28, 1984]

HON. FORTNEY H. (PETE) STARK (D., CALIF.), CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, ANNOUNCES A PUBLIC HEARING ON THE EXTENSION OF THE TARGETED JOBS TAX CREDIT AND THE EXCLUSION FOR GROUP LEGAL SERVICES PLANS ON TUESDAY, APRIL 10, 1984

The Honorable Fortney H. (Pete) Stark (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announces a public hearing on two extension issues: the targeted jobs tax credit and the income exclusion for group legal services plans. The hearing will be held on Tuesday, April 10, 1984, at 10 a.m. in Room H-137 of the Capitol.

In announcing this hearing, Chairman Stark stated, "In view of their year-end expiration, it is appropriate to examine each of these two provisions. Those who advocate an extension of these provisions have the burden of demonstrating the effectiveness of each of these provisions in achieving the policy goals originally intended by Congress."

BACKGROUND

Targeted jobs tax credit (Code sections 44B and 51).—The targeted jobs tax credit was enacted in the Revenue Act of 1978 (Public Law 95-600) to replace the expiring credit for increased employment (the "new jobs credit"). As originally enacted, the targeted jobs credit was available for wages paid before 1982. The availability of the credit was successively extended by the economic recovery Tax Act of 1981 (Public Law 97-34) and the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248) so that it may now be claimed by an employer for qualified wages paid for services performed in 1985 and 1986 to individuals who begin work for the employer before 1985.

The targeted jobs tax credit is available on an elective basis for hiring individuals from one or more of nine targeted groups. The targeted groups are: (1) Vocational rehabilitation referrals; (2) economically disadvantaged youths; (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) Aid to Families with Dependent Children (AFDC) recipients and Work Incentive Program (WIN) registrants; and (9) economically disadvantaged summer youth employees.

The credit generally is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. With respect to economically disadvantaged summer youth employees, however, the credit is equal to 85 percent of up to $3,000 of wages for a maximum credit of $2,550. The employer's deductions for wages must be reduced by the amount of the credit.

The Subcommittee is particularly interested in testimony providing information on how effective the credit has been in reducing unemployment in the targeted groups.

Exclusion for group legal services plans (Code sections 120, 501(c) (20), 3121(a) (17), and 3306(b) (12).—Present law provides that amounts contributed by an employer to a qualified group legal services plan for employees (or their spouses or dependents) are excluded from an employee's gross income for income tax purposes (Code section 120) and wages for employment tax purposes (Code sections 3121(a) (17) and 3306(b) (12)). Present law also provides that an organization created exclusively to form part of a qualified group legal services plan may be exempt from tax (Code section 501(c) (20)).

These provisions were first enacted in the Tax Reform Act of 1976 (Public Law 94-455), effective for taxable years beginning after December 31, 1976, and ending before January 1, 1982. The Economic Recovery Tax Act of 1981 (Public Law 97-34) subsequently extended this favorable tax treatment to apply to taxable years ending before January 1, 1985.

The Subcommittee is concerned over the lack of data available to make an informed decision as to whether an extension of the favorable tax treatment for qualified group legal services plans is appropriate. Therefore, the Subcommittee is particularly interested in testimony which documents the extent to which access to legal services has increased among the middle and lower income taxpayers for whom this incentive was intended.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler ((202) 225-3627) no later than close of business, Wednesday, April 4, 1984, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This procedure will afford more time for members to question witnesses. In order to expedite the hearing, witnesses may be grouped as panelists with strict time limitations for each panelist.

Requests to be heard must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where he or his designated representative may be reached);
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the written record of the hearing.

In order to assure the most productive use of the limited amount of time available to question witnesses, witnesses scheduled to appear before the Subcommittee must comply with the following rules:

1. All witnesses must submit 75 copies of their prepared statement to the full Committee office, Room 1102, Longworth House Office Building, not later than the close of business, Friday, April 6, 1984.
2. Witnesses should not read their written statements to the Subcommittee, but should instead limit their oral presentations to a summary of the points included in the statement.
3. Not more than five minutes will be allowed for the oral summary.

The Subcommittee wishes to emphasize that failure to comply with these requirements may result in the witnesses being denied the opportunity to testify in person or being deferred until all other testimony is heard.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

For those who wish to file a written statement for the printed record of the hearing, five copies are required and may be submitted to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102, Longworth House Office Building, Washington, D.C. 20515, by close of business, Tuesday, April 24, 1984. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing begins.

[Press release No. 13 of Wednesday, Mar. 28, 1984]

HON. FORTNEY H. (PETE) STARK (D., CALIF.), CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, ANNOUNCES A PUBLIC HEARING ON MISCELLANEOUS TAX BILLS TO BE HELD THURSDAY, APRIL 12, 1984

The Honorable Fortney H. (Pete) Stark, (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, today announced a public hearing on miscellaneous tax bills to be held Thursday, April 12, 1984, at 10:00 a.m., in the Committee's main hearing room, 1100 Longworth Building.

The lead-off witness at the hearing is expected to be the Treasury Department. Testimony is invited on the following bills:

H.R. 676.—(Mr. Shannon, Mr. Martin of North Carolina, Mr. Gephardt, Mr. Frenzel, Mr. Heftel of Hawaii, Mr. Vander Jagt, Mr. Fowler, Mr. Downey, Mr. Matsui, et al.): To amend the Internal Revenue Code of 1954 to provide that certain indebtedness incurred by educational organizations in acquiring or improving real property shall not be treated as acquisition indebtedness for purposes of the tax on unrelated business taxable income.

H.R. 2697.—(Ms. Mikulski, Mr. Campbell, Mr. Jacobs, Mr. Guarini, et al): To amend the Internal Revenue Code of 1954 to provide that the standard mileage rate for use of a passenger automobile which may be used in computing the charitable contribution deduction shall be the same as the standard mileage rate which may be used in computing the business expense deduction. Other related bills: H.R. 358 (Mr. Roe, et al) and H.R. 3212 (Mr. Hammerschmidt).

H.R. 4114.—(Mr. Guarini, Mr. Campbell, Mr. Frenzel, Mr. Ford of Tennessee, Mr. Duncan, Mr. Matsui, Mr. Vander Jagt, and Mr. Thomas of California): To amend the Internal Revenue Code of 1954 to defer the inclusion in income with respect to transfers of stock in a corporation pursuant to certain employee stock options.

H.R. 4357.—(Mr. Stark): To amend the Internal Revenue Code of 1954 to ensure stockholder protection with respect to the treatment of amounts received in certain corporate acquisitions, and for other purposes.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler ((202) 225-3627) no later than Noon, Friday, April 6, 1984, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This procedure will afford more time for members to question witnesses. In order to expedite the hearing, witnesses may be grouped as panelists with strict time limitations for each panelist.

Requests to be heard must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where he or his designated representative may be reached);
2. A list of any clients or persons, or any organization for whom the witness appears; and
3. A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the written record of the hearing.

In order to assure the most productive use of the limited amount of time available to question witnesses, witnesses scheduled to appear before the Subcommittee must comply with the following rules:

1. All witnesses must submit 75 copies of their prepared statement to the full Committee office, Room 1102, Longworth House Office Building, not later than noon Tuesday, April 10, 1984.
2. Witnesses should not read their written statements to the Subcommittee, but should instead limit their oral presentations to a summary of the points included in the statement.
3. Not more than five minutes will be allowed for the oral summary.

The Subcommittee wishes to emphasize that failure to comply with these requirements may result in the witnesses being denied the opportunity to testify in person or being deferred until all other testimony is heard.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

For those who wish to file a written statement for the printed record of the hearing, five copies are required and may be submitted to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102, Longworth House Office Building, Washington, D.C. 20515, by close of business, Thursday, April 26, 1984. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing begins.

[Press release of Wednesday, Apr. 4, 1984]

HON. FORTNEY H. (PETE) STARK (D., CALIF.), CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, ANNOUNCES A CHANGE IN THE SCHEDULE ON THE EXCLUSION FOR GROUP LEGAL SERVICES PLANS

The Honorable Fortney H. (Pete) Stark (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announced a change in the date for the public hearing previously scheduled to be held on Tuesday, April 10, 1984 (see Press Release #12), on the exclusion for group legal services plans. The hearing will now be held on Thursday, April 12, 1984, beginning at 10:00 a.m. in the Committee's main hearing room, 1100 Longworth Building, along with the previously scheduled miscellaneous bills (Press Release #13, dated March 28, 1984). All other hearing details remain the same.

Chairman **STARK**. Welcome to the committee Mr. Robert Woodward, Tax Legislative Counsel for the U.S. Department of the Treasury. Bob, you may proceed in any manner you see fit.

STATEMENT OF ROBERT G. WOODWARD, TAX LEGISLATIVE COUNSEL, U.S. DEPARTMENT OF THE TREASURY

Mr. **WOODWARD**. Thank you, Mr. Chairman.

I am pleased to present the views of the Treasury Department on the bills before the subcommittee this morning.

H.R. 676

The first bill is H.R. 676, which would provide an exemption from the unrelated business income tax for debt financed real property investments of schools. This exemption would be the same as currently provided for debt financed real estate investments by qualified pension trusts.

The debt financed property rules were intended to prevent the use of an exempt organization's tax exemption for the benefit of taxable persons. My written statement discusses the history of these rules and the abuses that required their enactment.

In the absence of the debt financed property rules, it would be much easier for exempt organizations to shift benefits to taxable persons through conversion of future ordinary income to capital gain income by the payment of a higher price for property than a taxable investor would pay, or through the transfer to a taxable person of the tax benefits associated with an investment made by a tax exempt organization.

We do not believe the provisions of H.R. 676 would prevent these uses of a tax exempt organization's exemption for the benefit of a taxable person. One possibility for abuse exists because the bill would permit nonrecourse financing by a party selling property to an educational institution if the financing provided is not subordinate to other debt on the property and the rate of interest is not significantly less than the market rate.

These restrictions would not prevent the conversion of ordinary income to capital gain income in the hands of the seller through the payment of an inflated price for the property based on the exempt organization's ability to receive rental income from the property tax free.

The bill also would create significant incentives for the development of methods for transferring to taxable persons the substantial tax benefits arising for the leverage real estate investments by tax exempt organizations. I must note that the bill passed by the House yesterday, H.R. 4170, does limit somewhat these types of arrangements but would not prevent them completely.

The bill also would give tax exempt educational institutions an incentive to solicit and accept gifts of real estate tax shelters that have passed the cross-over point at which the taxable income exceeds the cash flow produced. Charitable contributions of these investments would provide further tax advantages to taxable investors.

The proponents of this bill argue that the investment needs of the schools are no different from the investment needs of pension trusts and therefore the exception to the debt financed property rule for pension trusts should be extended to schools.

In enacting the special exception in the current law for pension trusts, Congress indicated that pension trusts were distinguishable from other tax exempt organizations because the purpose of the exemption for pension trusts was to permit the accumulation of investment income and because the assets of pension trusts are ultimately distributed in taxable form to pension recipients.

In view of these distinguishing characteristics, Congress considered it appropriate to provide a special rule for pension trusts alone. In fact, the law as enacted contains a specific statement that the exception for pension trusts is not to be considered as precedent for any further exceptions to the debt finance rules.

While the distinctions drawn between pension trusts and other tax exempt organizations may be tenuous, we do not think that the existence of a special exception for pension trusts justifies a similar exception for schools. We see the same problems with the pension trust exception as we have discussed concerning H.R. 676.

Since we do not consider the pension trust provision to be a desirable exception to the debt financed property rules, we oppose expansion of that provision.

Furthermore, the arguments for expansion of the pension trust exception to schools apply equally to other public charities and perhaps to all tax exempt organizations. In addition, a broad exception for debt financed investments in real estate could be used as precedent for adding exceptions for debt financed investments in other types of property.

For example, the pension trust exception has been used recently as a model for proposed legislation, S. 1549, to provide an exemption for debt financed investments in working interests in oil and gas wells.

We also note that the expansion of the pension trust exception to educational institutions would result in lost revenue of approximately $200 million in fiscal years 1985 through 1987.

The Treasury believes that the debt financed property rules are sound and should not be narrowed by piecemeal exceptions such as the one proposed in this bill for real estate investments by schools. Enactment of the bill would create new opportunities for abuses involving nonrecourse seller financing and the transfer to taxable persons of tax benefits attributable to investments by tax exempt organizations. Accordingly, we must oppose this bill.

I should note that the Senate Finance Committee recently has approved a provision that would extend to certain educational institutions the exception to the debt financed property rules currently provided for pension trusts. Under the Finance Committee provision, however, the exception would not be available to either pension trusts or schools if financing was provided by the seller or a party related to the seller, or if the debt financed property was acquired or held by a partnership in which taxable entities or organizations which are not eligible for the exception are partners.

The Finance Committee provision thus significantly reduces the opportunities for abuse. If the Congress decides to expand the exception to the debt financed property rules, we would strongly support the inclusion of the restrictions contained in the Senate provision.

Finally, we would like to bring to the committee's attention the possibility that pension funds may avoid the currently applicable restrictions on debt financed property through investments in segregated asset accounts of insurance companies. We would like to work with the committee to ensure that the rules cannot be avoided through the use of segregated asset accounts or through any other alternative investment vehicle.

H.R. 2697

The next bill that I will discuss is H.R. 2697, which would increase the standard mileage rate for purposes of computing charitable contribution deductions.

Under current rules, the rate taxpayers are permitted to use for computing the business expense deduction for use of an automobile is 20½ cents per mile for the first 15,000 miles; above 15,000 miles and for fully depreciated cars, the rate is 11 cents.

Taxpayers who use an automobile in connection with performing services for charitable organizations presently may use a standard mileage rate of 9 cents per mile in computing their charitable contribution deductions. Nine cents is also the mileage rate used for determining medical and moving expense deductions.

The reason for the difference in the two mileage rates is that the standard mileage rate permitted for purposes of the charitable contribution deduction reflects an allowance only for gas and oil, the only expenses deemed actually paid in performing the charitable service. On the other hand, the standard mileage rate for business use of an automobile reflects an additional allowance for costs that have a substantial fixed element, such as depreciation, insurance, general repairs and maintenance, and registration fees.

H.R. 2697 would provide that the amount of the charitable contribution deduction allowable for expenses incurred in the operation of an automobile in performing services for charitable organizations shall be determined at the same mileage rate used to compute business expense deductions.

Treasury must oppose this bill. Charitable use of automobiles typically accounts for a very small fraction of total use. Because of this, the owner of the vehicle would incur most of the cost attributable to owning his automobile whether or not he used the car for charitable activities. An owner incurs the vast majority of costs such as depreciation in value, general maintenance and insurance, merely as a result of the increasing age and personal use of the car.

Thus, such an owner should not be considered as paying to or for the benefit of charity costs that are largely fixed. While it may make sense to allocate these costs on a strictly pro rata basis for business vehicles where a large portion of use often is business use, such a pro rata allocation is not compelled in the charitable use setting.

I would like to note that the current charitable mileage allowance causes no significant unfairness to taxpayers. According to studies performed for the IRS, 9 cents per mile is a generous estimate of the costs of gasoline and oil. In addition, if a taxpayer's actual expenses for gasoline and oil in performing services for charity exceed 9 cents per mile, he may deduct the amount of his actual expenses in lieu of the mileage allowance.

Finally, increasing the charitable mileage allowance as proposed in H.R. 2697 would reduce Federal revenues by an estimated $445 million in fiscal years 1984 through 1987. These revenue losses would increase as years go by. In view of current Federal deficits, we would strongly oppose this reduction in Federal revenues.

H.R. 4114

The next bill before the subcommittee is H.R. 4114 which would provide new rules for the tax treatment of nonqualified stock options.

These special rules would be in addition to the provisions of section 422A of the code which already provides advantageous treatment for incentive stock options and section 423 which provides favorable tax treatment for options under qualified employee stock purchase plans.

Like the current law treatment of nonqualified options under section 83 of the Internal Revenue Code, the difference between the value of the stock at the exercise date of the option and the option price paid, would constitute ordinary income to the employee under the bill and there would be a corresponding business expense deduction to the employer.

However, unlike the current rules relating to nonqualified options, the employee would be able, subject to the employer's agreement, to defer recognition of ordinary income on the option spread from the date of option exercise until the date of disposition of the stock.

The amount included in ordinary income would not be affected by any appreciation or depreciation in the value of the option stock after the date of exercise. Instead, that would qualify for capital gain treatment on the subsequent disposition.

The corporation's deduction would also be deferred until the disposition of the option stock.

We understand that the sponsors of this bill have agreed to certain amendments to the bill as originally introduced, which are designed to limit the abuse of these tax-deferred nonqualified options by highly compensated employees. These amendments would impose on this new class of options certain limitations similar to those now applicable to incentive stock options, including a

$100,000 per year cap on the amount of options granted to any employee, and a requirement that the options be exercised in the order granted.

The Treasury Department strongly opposes this bill. It would create an unnecessary exception from the rules of section 83 over and above the two provisions already in the code allowing favorable treatment of employee stock options. By providing yet another means for highly compensated individuals to enjoy special tax benefits, enactment of the bill would further undermine the public's perception of the fairness of the income tax system.

In creating this tax deferral opportunity for employees who exercise nonqualified stock options, the bill admittedly would require the employer corporation to agree to the corresponding deferral of its compensation deduction. However, in many cases, the employer's approval would not be difficult to obtain, especially in the case of key employees who likely would participate in the employer's decision. Furthermore, such a joint election by the corporation and its employee is likely to be filed only in situations where there is a net tax savings as between the corporation and employee.

The additional limitations suggested by the sponsors of the bill will not, in our opinion, eliminate abuse of this provision by officers, shareholders, and highly compensated employees. If these option programs are indeed intended for use by a broad-based cross-section of employees, nondiscrimination rules must be added to the bill, similar to the rules applicable to most other statutory fringe benefits.

We also recommend that, like incentive stock options, these options should be granted at a price not less than the fair-market value of the underlying stock at the date of the grant, and to be exercisable during the employee's lifetime only by the employee. Our written statement goes into some other limitations that we would suggest, which are really needed if this new type of stock option is truly to be made available to a nondiscriminatory cross-section of employees.

Nevertheless, even if those modifications were made to the bill, we would still have to oppose the legislation.

H.R. 4357

The next bill is H.R. 4357, which deals with preferential payments to certain shareholders in corporate acquisitions, and with so-called golden parachute arrangements.

There has recently been a significant amount of publicity about corporate stock acquisitions in which a higher purchase price per share is offered to large shareholders of the target corporation than is offered to smaller shareholders. In addition, there has been a great deal of publicity concerning so-called golden parachute arrangements for key personnel of corporations, anticipating the possibility of hostile takeover attempts.

Typically, these arrangements provide for the payment of cash or property frequently in excess—much in excess—of historic compensation to key executives in the event of a change or threatened change in ownership or control of the employer corporation.

We realize that there has been a great deal of concern about the fairness of these arrangements to shareholders, particularly minority shareholders, of corporations.

In response to that concern, H.R. 4357 would amend the Internal Revenue Code in two respects to discourage these kinds of arrangements:

First, in the case of stock purchased for more than its fair-market value from any shareholder owning 1 percent or more of the voting power of the corporation, the shareholder would include in gross income, as ordinary income, the full amount of any gain realized on the transaction, and the company would be disallowed any deduction for any amount attributable to the transaction.

Second, the corporation would be denied any deduction for payments made under a management-protection agreement that discriminates in favor of officers, shareholders, and highly compensated employees. An employee who enters into such an agreement would include in gross income in the year of termination of services the present value of all future amounts to be paid under the agreement.

The Treasury Department cannot support this bill. We do not see the necessity of addressing either type of arrangement, troubling as they may be, through changes in the income tax law. These arrangements can be addressed sensibly and effectively by the Securities and Exchange Commission and through State law limitations on corporate waste and unequal treatment of shareholders.

I am sure that the subcommittee is aware that the Finance Committee has included provisions in its bill recently reported that are similar in purpose, if not in technical details, to H.R. 4357. The provision in the Finance Committee bill would disallow all deductions by a corporation under a management protection agreement unless the corporation disproved the presumption of unreasonableness of that type of compensation.

We have a problem with that in that it disallows not only the excessive amount, but amounts that might be shown to be reasonable simply because it would be paid under an agreement that would be subject to the restrictions. We think that some further modification is needed in that provision in the Finance Committee bill.

H.R. 5028

The last bill before the subcommittee is H.R. 5028 which would extend the provisions in the Tax Code for tax-free group legal services plans.

Section 120 of the Internal Revenue Code provides an exclusion from an employee's gross income for amounts contributed by an employer to a qualified group legal services plan for employees, or their spouses, or dependents. The exclusion also applies to the value of any personal legal services rendered or amounts paid for legal services under the plan for an employee or the employee's spouse or dependents.

The code also provides tax-exempt status for any trust or organization that functions exclusively to accept funds for or otherwise forms part of a group legal services plan.

In order to qualify for this exclusion, the group legal services plan must meet a number of qualification requirements.

The exclusion as originally enacted in 1976 was available only for taxable years ending before 1982, but it was extended through the end of 1984 by the Economic Recovery Tax Act of 1981.

Treasury opposed both the enactment of section 120 in 1976 and its extenstion in 1981 on grounds that equity requires that compensation received in the form of personal legal services, whether paid in kind or in cash, should be taxed the same as any other type of compensation received by employees. Providing an exclusion from income for employer provided personal legal services is contrary to the well established tax policy of denying tax deductions for personal expenditures.

These plans are limited in their payments for personal expenditures and do not cover cases in which the employee would have an offsetting business deduction.

H.R. 5028 would eliminate the 1984 sunset of section 120 and would extend the provision permanently. Similarly, it would continue the tax exempt status of group legal services organizations.

We oppose this bill for the same reasons we opposed the enactment of section 120 in 1976. We believe that compensation paid in the form of legal services should be taxed in the same manner as any other type of compensation received by employees. The existence of special exemptions for particular types of compensation only encourages employees to rearrange their affairs so that compensation is received in a nontaxable form. The exclusion for group legal benefits permits certain employees to pay no tax on their personal legal costs simply because their employers operate these plans. This produces an inequitable tax advantage for participants in these plans over other individuals who cannot deduct their personal legal expenses.

Moreover, even among participants in these plans, the tax exclusion provides the greatest tax benefits to participants with the largest income.

We have some other concerns which are outlined in our written statement.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions that you may have.

[The prepared statement follows:]

STATEMENT OF ROBERT G. WOODWARD, TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee: I am pleased to present the views of the Treasury Department on the following bills:

H.R. 676, which would extend to certain educational institution, the exception from the debt-financed property rules that is currently applicable to qualified pension trusts;

H.R. 2697, which would increase the mileage allowance for charitable deduction purposes to that allowed for the business expense deduction;

H.R. 4114, which would allow a deferral of an employee's income and employer's deduction from the date of exercise of a nonqualified employee stock option until the date of disposition of the stock received on exercise of the option;

H.R. 4357, which would eliminate capital gain treatment for gains on certain sales of stock by key shareholders and would deny deductions to corporations for payments under so-called "golden parachute" contracts; and

H.R. 5028, which would allow a permanent exclusion for benefits under group legal services plans.

I will discuss each bill in turn.

H.R. 676—EXEMPTION FROM THE UNRELATED BUSINESS INCOME TAX FOR DEBT-FINANCED REAL PROPERTY INVESTMENTS OF SCHOOLS

Background

Although exempt organizations generally are exempt from tax, a tax is imposed on income earned by an exempt organization from business activities that are unrelated to its exempt purpose. Exceptions to this tax on unrelated business income are provided for certain traditional types of investment income (rents, royalties, dividends, and interest) unless the acquisition or improvement of the property producing the income is financed by debt. Subject to limited exceptions, a share of any income from debt-financed property, proportional to the ratio of debt on the property to the adjusted basis of the property, is treated as income from an unrelated trade or business.

The original rules relating to debt-financed property were enacted in 1950 in response to abusive sale-leaseback transactions between tax-exempt organizations and taxable owners of active businesses. These transactions typically involved a tax-exempt organization's purchase of an active business, financed primarily by a contingent, nonrecourse note, followed by a lease of the assets of the business to the seller. The effect of these transactions was to convert the ordinary income of the business into capital gains for the seller while allowing the tax-exempt organization eventually to acquire property with little or no investment of its own funds. The primary objection to sale-leaseback arrangements involving borrowed funds was that they permitted an organization's tax exemption to benefit the taxable seller, either by conversion of ordinary income into capital gain income or by payment of a higher price for the property than a taxable purchaser would pay.

Unfortunately, the 1950 legislation to tax income from certain leases was insufficient to prevent abuse because new forms of transactions involving leveraged investments quickly developed. In response to these new transactions, the unrelated business income tax rules were strengthened in 1969 by subjecting to tax the income received from all kinds of debt-financed property. This broad revision was designed to deal with all types of abuses involving leveraged investments by tax-exempt organizations.

An exception to the debt-financed property rules was added to the Internal Revenue Code by the Miscellaneous Revenue Act of 1980 (P.L. 96–604) for debt-financed real property investments of pension trusts that satisfy certain conditions. Section 110(b) of that Act specifically stated that this exception was not to be considered precedent for extending the exception to other exempt organizations. The stated reason for providing this special exception was that exemption for investment income of qualified retirement trusts is an essential tax incentive which is provided to tax-qualified plans in order to enable them to accumulate funds to satisfy their exempt purpose—the payment of employee benfits. The reason for limiting the exception to investments by pension trusts was that the assets of such trusts will ultimately be used to pay taxable benefits to individual recipients, whereas the investment assets of other exempt organizations are not likely to be used for the purpose of providing benefits that will be taxable at individual rates.

H.R. 676

H.R. 676 would provide an exception to the debt-financed rules for investments in real estate by schools and certain affiliated support organizations. However, the exception would not apply to a real estate investment if—

(1) the acquisition price is not a fixed amount;

(2) the amount of any indebtedness, any amount payable with respect to any indebtedness, or the time for making any payment with respect to any indebtedness is dependent upon the revenue, income, or profits derived from the real property;

(3) the real property is at any time after the acquisition leased to the seller or to certain persons related to the seller;

(4) the seller or any person related to the seller provides nonrecourse financing in connection with the acquisition of the real property and such debt is subordinate to any other indebtedness on the property or bears a rate of interest which is significantly less than the rate available from an unrelated person.

The bill would apply to taxable years beginning after December 31, 1982.

Discussion

The debt-financed property rules are intended to prevent the use of an exempt organization's tax exemption for the benefit of taxable persons. In the absence of the debt-financed property rules, it would be much easier to provide benefits to taxable persons through conversion of ordinary income to capital gain income, through the payment of a higher price for property than a taxable investor would pay, or through the transfer to a taxable person of the tax benefits associated with an investment made by a tax-exempt organization. We do not believe the provisions of H.R. 676 would prevent these uses of a tax-exempt organization's exemption for the benefit of a taxable person.

One possibility for abuse exists because the bill would permit nonrecourse financing by the seller if the financing provided is not subordinate to other debt on the property and the rate of interest is not significantly less than the market rate. These restrictions would not prevent the conversion of ordinary income to capital gain income in the hands of the seller or the payment of an inflated price for the property based on the exempt organization's ability to receive rental income from the property tax-free.

The bill also would create significant incentives for the development of methods for transferring to taxable persons the substantial tax benefits arising from leveraged real estate investments by tax-exempt organizations. H.R. 676 contains no provisions to prevent partnership allocations that would transfer the tax benefits on a partnership's real estate investment from tax-exempt partners to taxable partners. Through such partnership allocations, taxable persons could obtain significant tax deferral benefits and could convert ordinary income to capital gain income in a wide variety of transactions. Indeed, the possibilities for using partnership allocations to transfer tax benefits from tax-exempt partners to taxable partners are so varied that it is doubtful that rules could be drafted to prevent all abuses of this sort. Additionally, the bill would give tax-exempt educational institutions an incentive to solicit and accept gifts of real estate tax shelters that have passed the "crossover" point at which the taxable income exceeds the cash flow produced. Charitable contributions of such investments would provide further tax advantages to the taxable investors.

The proponents of H.R. 676 argue that the investment needs of schools are no different from the investment needs of pension trusts, and therefore the exception to the debt-financed property rules for pension trusts should be extended to schools. In enacting the special exception for pension trusts, Congress indicated that pension trusts were distinguishable from other tax-exempt organizations because the purpose of the exemption for pension trusts was to permit the accumulation of investment income and because the assets of pension trusts are ultimately taxed to pension recipients. In view of these distinguishing characteristics, Congress considered it appropriate to provide a special rule for pension trusts alone. In fact, the law as enacted contains a specific statement that the exception for pension trusts is not to be considered as precedent for any further exceptions to the debt-financed rules.

While the distinctions drawn between pension trusts and other tax-exempt organizations may be tenuous, we do not think that the existence of a special exception for pension trusts justifies a similar exception for schools. We see the same problems with the pension trust exception as we have discussed concerning H.R. 676. Since we do not consider the pension trust provision to be a desirable exception to the debt-financed property rules, we oppose expansion of that provision.

Furthermore, the arguments for expansion of the pension trust exception to schools apply equally to other public charities, and perhaps to all tax-exempt organizations. In addition, a broad exception for debt-financed investments in real estate could be used as precedent for adding exceptions for debt-financed investments in other types of property. For example, the pension trust exception has been used as a model for proposed legislation (S. 1549) to provide an exemption for debt-financed investments in working interests in oil and gas wells.

We also note that expansion of the pension trust exception to educational institutions would result in a revenue loss of approximately $200 million in fiscal years 1985 through 1987.

The Treasury Department believes that the debt-financed property rules are sound and should not be narrowed by piecemeal exceptions such as the one proposed in this bill for real estate investments by schools. Enactment of the bill would create new opportunities for abuses involving nonrecourse seller financing and the transfer to taxable persons of tax benefits attributable to investments by tax-exempt organizations. Accordingly, we must oppose H.R. 676.

The Senate Finance Committee recently approved a provision that would extend to certain educational institutions the exception to the debt-financed property rules currently provided for pension trusts. Under the Finance Committee provision, however, the exception would not be available to either pension trusts or schools if financing was provided by the seller or a party related to the seller, or if the debt-financed property was acquired or held by a partnership in which taxable entities or organizations which are not eligible for the exception are partners. The Finance Committee provision thus significantly reduces the opportunities for abuse. If the Congress decides to expand the exception to the debt-financed property rules, we would strongly support the inclusion of the restrictions contained in the Senate provision.

Finally, we would like to bring to the Committee's attention the possibility that pension trusts may avoid the currently applicable restrictions on debt-financed property through investments in qualified segregated asset accounts of insurance companies. We would like to work with the Committee to ensure that the rules cannot be avoided through the use of segregated asset accounts or any other collective investment vehicle.

H.R. 2697—INCREASE IN STANDARD MILEAGE RATE FOR PURPOSES OF COMPUTING CHARITABLE CONTRIBUTION DEDUCTIONS

Background

Under current rules the rate taxpayers are permitted to use for computing the business expense deduction for use of an automobile is 20.5 cents per mile for the first 15,000 miles. (Above 15,000 miles, and for fully depreciated cars, the rate is 11 cents.) Taxpayers who use an automobile in connection with performing services for charitable organizations presently may use a standard mileage rate of 9 cents per mile in computing their charitable contribution deductions. (Nine cents also is the mileage rate used for determining medical and moving expense deductions). The reason for the difference in the two mileage rates is that the standard mileage rate permitted for purposes of the charitable contribution deduction reflects an allowance only for gas and oil—the only expenses actually paid in performing the charitable service. On the other hand, the standard mileage rate for business use of an automobile reflects an additional allowance for depreciation, insurance, general repairs and maintenance, and registration fees.

H.R. 2697

H.R. 2697 would amend section 170 of the Internal Revenue Code to provide that the amount of the charitable contribution deduction allowable for expenses incurred in the operation of an automobile in performing services for a charitable organization shall be determined at the same mileage rate used to compute business expense deductions.

Discussion

Allowance of the lower mileage rate for purposes of the charitable contribution deduction reflects the longstanding administrative position that the only expenses for which charitable deductions should be allowed are those actually paid by the taxpayer in performing the charitable service. We believe there are sound reasons for this administrative position, upon which the different mileage rates are based. Accordingly, the Treasury Department opposes H.R. 2697.

Section 170 of the Code allows a deduction for contributions or gifts to, or for the use of, a qualifying charity only if "payment is made within the taxable year." Because the Code requires "payment," the charitable deduction of a taxpayer who operates his vehicle in performing services for charity is limited to the taxpayer's out-of-pocket costs. Since gasoline and oil are the only items that the taxpayer buys to use solely for the charity, the cost of gas and oil is the only automobile expense that is properly deductible. This interpretation of the law is carried out through the 9 cent mileage allowance.

The "payment" requirement contained in section 170, as it applies to the use of automobiles, is appropriate because it is difficult to quantify indirect costs that are properly attributable to charitable use of automobiles. Charitable use of automobiles typically accounts for a very small fraction of total use. Because of this, the owner of the vehicle would incur most costs attributable to owning his automobile whether or not he used the car for charitable activities. An owner incurs the vast majority of costs, such as depreciation in value, general maintenance, and insurance, merely as a result of the increasing age and the personal use of his car. Thus, such an owner should not be considered as "paying" to or for the benefit of charity costs that are largely fixed. While it may make sense to allocate these costs on a strictly pro rata basis for business vehicles, where a large portion of use often is business use, such a pro rata allocation does not reflect economic reality in the charitable use setting.

Another reason for maintaining the "payment" requirement as it applies to automobile use is to avoid setting an undesirable precedent for determining deductions for charitable use of other property. If charitable deductions were allowed for indirect costs of operating an automobile, then similar deductions logically should be allowed for charitable use of other property, such as wear and tear on a home made available for occasional use by a charity. If this were done, the IRS would be faced with significant compliance problems.

It should be noted that the current charitable mileage allowance causes no significant unfairness to taxpayers. According to studies performed for the IRS, 9 cents per mile is a generous estimate of the costs of gasoline and oil. In addition, if a taxpayer's actual expenses for gasoline and oil in performing services for charity exceed 9 cents per mile, he may deduct the amount of his actual expenses in lieu of the mileage allowance.

Finally, increasing the charitable mileage allowance as proposed in H.R. 2697 would reduce Federal revenues by an estimated $445 million in fiscal years 1984 through 1987. These revenue losses would increase each year. In view of current Federal deficits, we strongly oppose this reduction in Federal revenues.

H.R. 4114—TAX TREATMENT OF NONQUALIFIED EMPLOYEE STOCK OPTIONS

Background

Under present law, the tax treatment of employee stock options generally is governed by section 83 in the case of nonqualified options, or by section 421 in the case of options granted pursuant to employee stock purchase plans meeting the requirements of section 423, or incentive stock options meeting the requirements of section 422A. Section 83 provides that the value of a stock option constitutes ordinary income to the employee when granted only if the option itself has a readily ascertainable fair market value at that time. Employees receiving options without a readily ascertainable value are taxed when the option is exercised (or six months later, if the stock is subject to certain securities law restrictions) on the difference between the value of the stock at exercise and the option price. The timing of the employer's deduction coincides with the employee's recognition of income.

In the case of options granted under employee stock purchase plans, there are no tax consequences upon either grant or exercise of the option. Instead, provided that the option is priced at least 100 percent of the stock's fair market value at date of grant, and the employee meets special holding period requirements, the employee is taxed when the stock is sold at capital gain rates upon any fluctuations in the stock's fair market value following the date of option grant. If the option was priced at between 85 percent and 100 percent of the stock's fair market value at the date of grant, the employee is taxed upon sale of the stock at ordinary income rates on the amount of any such discount (or, if less, on the difference between the fair market value of the stock at the date of disposition and the amount paid for the stock under the option), and at capital gain rates on any gain in the stock's value over the fair market value of the stock on the date of option grant. No business expense deduction is allowed to the employer with respect to the grant or exercise of an employee stock purchase plan option, although the employer can claim a business expense deduction at the time the employee disposes of the stock in the amount of any ordinary income recognized at that time by the employee. In order for these options to qualify for this special treatment, an employee stock purchase plan by its terms must not grant options to any employees who own (or possess options to purchase) more than 5 percent of the corporation, but must grant options on a nondiscriminatory basis to all other employees (with the exception of part-time employees, recent hires, officers, supervisors, and highly compensated employees). In addition, the option price must equal or exceed 85 percent of the stock's fair market value at time of grant. Finally, no employee may purchase more than $25,000 in optioned stock in any year.

In the case of incentive stock options (ISOs), there are no tax consequences when the option is granted or when the option is exercised (except for possible alternative minimum tax consequences to the employee). If the employee holds the stock for a special time period after exercise of the option, the employee is taxed at capital gain rates when the stock is sold. No business expense deduction is allowed to the employer with respect to the grant or exercise of an ISO. In order to qualify for this special treatment, an ISO must satisfy a number of different requirements outlined in section 422A. For example, the option price must equal or exceed the stock's fair market value at the time of grant. No more than $100,000 in ISOs may be granted to any employee in any year. ISOs must be nontransferable, except by reason of death of the employee. Finally, no ISO can be exercised while an earlier ISO is outstanding.

H.R. 4114

H.R. 4114 would provide new rules for the tax treatment of nonqualified stock options. Like current law, the difference between the value of the stock at the exercise date and the option price would constitute ordinary income to the employee, and a corresponding business expense deduction to the employer. However, unlike the current rules relating to nonqualified options, the employee would be able (subject to the employer's agreement) to defer recognition of ordinary income on the option spread from the date of option exercise until the date of disposition of the stock. The amount included in ordinary income would not be affected by any appreciation or depreciation in the value of the option stock after the date of exercise. Instead, the amount included in ordinary income would be added to the basis of the stock for purposes of determining capital gain or loss from the disposition. The corporation's deduction would also be deferred until the date of disposition of the option stock.

We understand that the sponsors of H.R. 4114 have agreed to certain amendments to the bill as introduced, which are designed to limit the abuse of these tax-deferred nonqualified options by highly compensated employees. These amendments would impose on this new class of options certain limitations similar to those affecting ISOs, including a $100,000 per year cap on the amount of options granted to any employee and a requirements that the options be exercised in the order granted.

Discussion

The Treasury Department strongly opposes H.R. 4114. This bill would create an unnecessary exception from the rules of section 83, by allowing an employee to defer tax indefinitely on compensation paid in the form of stock transferred pursuant to the exercise of an option which had no readily ascertainable fair market value when granted. Section 83 currently allows an employee who receives property in exchange for services to defer recognition of income only until the lapse of any restrictions upon the sale of such property. No employee should be allowed to defer income recognition beyond the date on which he could sell the property that is transferred to him. By providing yet another means for highly compensated individuals to enjoy special tax benefits, enactment of this bill would further undermine the public's perception of the fairness of the income tax system.

In creating this tax deferral opportunity for employees who exercise nonqualified stock options, H.R. 4114 admittedly requires the employer corporation to agree to the corresponding deferral of its deduction. However, in many cases the employer's approval would not be difficult to obtain, especially in the case of key employees who likely would participate in the employer's decision. Furthermore, such a joint election by the corporation and its employee is likely to be filed only in situations where there is a net tax savings as between the corporation and the employee.

The additional limitations suggested by the sponsors of the bill will not, in our opinion, eliminate abuse of this provision by officers, shareholders, and highly compensated employees. If these option programs are indeed intended (as the sponsors of H.R. 4114 have asserted) for use by a broad-based cross section of employees, then nondiscrimination rules must be added to the bill, similar to the rules applicable to other statutory fringe benefits. For example, no more than 25 percent of these options should be provided to the class of employees who are owners of 5 percent or more of the stock, company officers, or employees whose annual compensation exceeds two times the defined contribution limitation for pension plans (currently $60,000). The same percentage limitations should apply to employees benefitting from elections by the employer to defer tax on option exercise. In addition, to ensure further against abuse of these provisions by highly compensated employees, the $100,000 annual limit on option grants to any employee should be reduced by any ISOs granted to the employee in that year, and any amount deferred by reason of the election should be treated as an item of tax preference for purposes of the individual alternative minimum tax.

We also recommend that, like ISOs, these options should be granted at a price not less than the fair market value of the underlying stock at the date of grant, and that they be exercisable during the employee's lifetime only by the employee. Moreover, in order to avoid loss of revenues to the social security system, we recommend that the bill be clarified to insure that the option spread will be subject to both employer and employee (FICA taxes at the time of option exercise. (If social security taxes were deferred as well as income taxes, and if the stock received on exercise were sold after an employee's termination of services, it is likely that both the employee and employer could argue that no FICA taxes were owed after the employee's retirement.) Finally, we recommend that the rules of H.R. 4114 governing the deferral election by the employer and employee be clarified to require that the election be filed within a short period of time after exercise of the option. As proposed in the bill, option stock covered by such an election should either be retained by the corporation for the benefit of the employee, or stamped with a restricitve legend or stop-transfer instruction indicating that the corporation must be notified of any transfer.

The above-described limitations would help ensure that this new type of stock option would be made available to a nondiscriminatory cross-section of employees. Nevertheless, even if the bill were modified to include these limitations, we would continue our opposition to this legislation.

H.R. 4357—PREFERENTIAL PAYMENTS AND GOLDEN PARACHUTE ARRANGEMENTS

Background

Recently there has been a significant amount of publicity about corporate stock acquisitions in which a higher purchase price per share is offered to large shareholders of the target corporation than is offerd to smaller shareholders. In addition, there has been a great deal of publicity concerning so-called "golden parachute" arrangements between corporations anticipating the possibility of a hostile takeover attempt and their key personnel. Typically these arrangements provide for the payment of cash or property (frequently in excess of historic compensation) to key executives in the event of a change (or threatened change) in ownership or control of the employer corporation.

H.R. 4357

H.R. 4357 would amend the Internal Revenue Code in two respects to penalize the arrangements described above. First, in the case of stock purchased for more than its fair market value from any shareholder owning one percent or more of the voting power of the corporation, the shareholder would include in gross income as ordinary income any gain realized on the transaction, and the company would be disallowed any deduction for any amount attributable to the transaction. Second, a corporation would be denied any deduction for payments under any managment protection agreement that discriminates in favor of officers, shareholders, or highly compensated employees. An employee who enters into such an agreement would include in gross income in the year of termination of services the present value of all amounts (including property) to be paid under the agreement.

Discussion

The Treasury Department cannot support H.R. 4357. We question in general the necessity of addressing either type of arrangement, troubling as they may be, through changes in the income tax law. These arrangements can be addressed much more sensibly and effectively by the Securities and Exchange Commission and through state law limitations on corporate waste and unequal treatment of shareholders.

H.R. 5028—EXTENSION OF TAX-FREE GROUP LEGAL SERVICES PLANS

Background

Effective for taxable years beginning after 1976 and before 1985, section 120 of the Internal Revenue Code provides an exclusion from an employee's gross income for amounts contributed by an employer to a qualified group legal services plan for employees or their spouses or dependents. The exclusion also applies to the value of any personal legal services rendered (or reimbursements for such services paid) under the plan to an employee, or to the employee's spouse or dependents. Section 501(c)(20) provides tax-exempt status for any trust or organization that functions exclusively to accept funds for, or otherwise forms part of, a group legal services plan.

In order to qualify for this exclusion, a group legal services plan must meet a number of requirements. First, the legal services must be provided for the exclusive benefit of employees or their spouses or dependents. Second, the plan must provide only "personal" legal services and cannot provide legal services relating either to a participant's trade or business or to the management, conservation or preservation of property held for the production of income. Third, the employer must fund the plan through prepayment of, or advance provision for, all or a part of the legal benefits provided under the plan. These prepaid employer contributions must be paid either (a) to insurance companies or to organizations or persons that provide personal legal services or indemnification against the cost of such services; (b) to tax-exempt group legal service organizations; (c) to other tax-exempt organizations that pay or credit the employer contributions to a tax-exempt group legal services organization; (d) to providers of personal legal services under the plan; or (e) to a combination of the above-listed permissible arrangements.

The fourth qualification requirement is that the plan must not discriminate in either contributions, benefits, or eligibility for enrollment, in favor of officers, shareholders, self-employed individuals, or highly compensated employees. In addition, no more than 25 percent of the plan contributions can be provided to owners of more than 5 percent of the business (or to their spouses or dependents). The final qualification requirement is that the plan must apply to the Internal Revenue Service for recognition of its satisfaction of all the above-listed rules.

Code section 120 was enacted in 1976 in order to create a means for employers to provide tax-free personal legal services to their employees. The exclusion as originally enacted was available only for taxable years ending before January 1, 1982, but was extended through the end of 1984 by the Economic Recovery Tax Act of 1981.

Prior to the enactment of section 120, any employer-provided legal services were included in an employee's gross income. Employees could then deduct only the cost of those legal services rendered in connection with a trade or business or investment property, or in connection with the determination, collection or refund of any tax. By enacting section 120, Congress has created a tax exclusion for otherwise nondeductible personal legal services provided to employees through employer-funded plans.

This exclusion is in two respects more attractive to employees than the deduction available for business-related legal services. First, the exclusion applies to any employee receiving legal services under the plan, whereas a comparable business expense deduction generally would be available only to employees who are able to itemize their deductions. Second, employer-provided group legal services benefits are free from social security taxes as well as from income taxes. No comparable exclusion exists for wages used to pay business-related legal services.

Treasury opposed both the enactment of section 120 in 1976 and its extension in 1981, on ground that equity requires that compensation received in the form of personal legal services (whether paid in kind or in cash) should be taxed the same as any other type of compensation received by employees. Providing an exclusion from income for employer-provided personal legal services is contrary to the well established tax policy of denying tax deductions for personal expenditures.

H.R. 5028

H.R. 5028 would eliminate the December 31, 1984 sunset of section 120 and extend the provision permanently. The bill also would continue the tax-exempt status of group legal services organizations.

Discussion

The Treasury Department opposes H.R. 5028 for the same reasons we opposed the enactment of section 120 in 1976. Compensation paid in the form of legal services should be taxed in the same manner as any other type of compensation received by employees. The existence of special exemptions for particular types of compensation only encourages employees to rearrange their affairs so that compensation is received in a non-taxable form. The restructuring of an employee's compensation package to substitute nontaxable legal services for taxable compensation is made easier whenever group legal services are offered as an alternative to cash or other benefits under a cafeteria plan. The exclusion for group legal benefits permits certain employees to pay no tax on their personal legal costs, simply because their employers operate qualified section 120 plans. This produces an inequitable tax advantage for participants in group legal services plans over all other individuals (who cannot deduct their person legal expenses). Moreover, even among participants in any given section 120 plan, the tax exclusion provides the greatest tax benefits to participants with the largest incomes.

We also are concerned that both the rules granting tax-exempt status to group legal services organizations and governing employer deductions for contributions to such organizations provide unwarranted tax advantages. The tax exemption accorded to the income of group legal services organizations reduces both the income and social security tax bases and thus requires higher tax rates to be imposed on other forms of income. Furthermore, the current rules governing an employer's deduction for contributions to a group legal services organization provide an employer with excessive discretion in determining the level of deductible contributions that may be made for any year. The result is that an employer—particularly a closely held company—may be able to use such an organization as a tax-favored savings account for its own and its key employees' benefit.

For these reasons, we oppose the extension of the exclusion from gross income for payments to or under qualified group legal services plans and the tax exemption for group legal services organizations.

That concludes my prepared remarks. I would be happy to answer any questions you may have.

Chairman **Stark**. Bob, thank you.

We did not do so well with you guys today, did we?

Mr. **Woodward**. Well, as you know, these are all Senate provisions originally and were not included in the bill recently reported out by this committee.

Chairman **Stark**. The Chair has a certain pride in authorship in part of it. But let me start with the admonishment first:

I assume because you are opposing the group legal services plan that the Treasury has completed their study on the desirability of extending legal services, which was requested in the Tax Reform Act of 1976 and was supposed to be submitted to this committee by December 31, 1980.

I am sure that Treasury is basing their objection on a thorough study that they have done, and we are just waiting for the Labor Department to come up with their half of the study. Is that correct?

Mr. **Woodward**. I am sure that the chairman's assumption is absolutely correct.

Chairman **Stark**. I wonder if we could see the Treasury's half of the study at your convenience. It would probably change the minds of the committee on what we ought to do on extending these, and I know, in the thorough way that the Treasury operates, that you based your decision on an indepth study of the proposal.

Mr. **Woodward**. I think our position is based on tax policy grounds, apart from the impact on legal services, but——

Chairman **Stark**. Don't confuse me with the facts, just a broad philosophic objection.

Mr. **Woodward**. I made an inquiry on discovering that I would have to explain this morning why the 1976 mandate had not been fulfilled, and that the 1981 reminder was not sufficient.

Chairman **Stark**. The Carter administration scuttled it?

Mr. **Woodward**. Apparently so.

But we have now reassigned it just this week. [Laughter.]

To a new staff member.

Chairman **Stark**. To the summer interns. [Laughter.]

Now, I presume further that in your statement on the golden parachute arrangements, you indicate that these arrangements could be much more sensibly and effectively dealt with by the Securities and Exchange Commission because the issue is basically unequal treatment of shareholders.

Mr. **Woodward**. That is correct, Mr. Chairman.

Chairman **Stark**. I presume by the same ironclad logic and Thomasian reasoning that if we were to deal today with the investment tax credit, the main thrust of which was to create jobs, that you would oppose it and suggest that either the Labor Department or the Commerce Department would be the proper forum for dealing with that, as, obviously, investment tax credit has no sensible tax philosophy, it is strictly a job-creating part of the code.

So, the same reasoning, I assume, would apply, that there would be a better area, some other department would be better suited to make that decision than Treasury.

Mr. **Woodward**. If the purpose of the investment tax credit were to provide subsidies only to very narrow classes of property or property investments by designated companies, that might be the case.

I think that the investment credit, though, is generally pretty broad. Its qualifications are based on generally objective criteria. Clearly, we cannot seriously suggest to the Congress that either we or the Congress should strike out from the tax law all provisions which might be reflecting some arguably nontax policy.

I think our concern with respect to these types of arrangements is that they are all different types and the inquiry is a fairly subjective one that we feel fairly uncomfortable about defining through the blunt instrument of the Tax Code.

There are limitations in the Tax Code on deductions for unreasonable compensation. Those would be applicable to these kinds of arrangements. That is always a difficult fact case to prove as well.

Chairman **Stark**. That being the case, I would inquire as to whether the Treasury might find the Senate's approach to this somewhat less objectionable than the bill that is introduced in the House in that I believe that deals with presumption of proving that it is reasonable and might make it easier for you to enforce.

Mr. **Woodward**. That is correct. We are still troubled by the fact that the disallowance is the entire amount of the payments, even though some portion of them might be shown to be reasonable.

We also have some problems with the excise tax which is imposed on the employee recipient of these payments under the Senate bill. It is not a steep tax but it is significant. We are concerned that they may sweep too broadly, frankly, and might affect some arrangements that no one would intend to impose a penalty upon.

Chairman **Stark**. Do you know whether you have actually been successful in disallowing any compensation provisions that were uniquely triggered by merger or acquisition-type situations? I know you are constantly challenging regular salaries, particularly of Members of Congress who hold outside work and may collect much more director's fees than they are worth. But in that sense, do you know of any that go after some of these?

Mr. **Woodward**. I do not know of any IRS challenges, Mr. Chairman. I would think that many of these arrangements are of fairly recent vintage and might not yet be in the audit cycle.

Chairman **Stark**. Your opposition to H.R. 2697, I believe, is the Senate provision for business, for automobiles. Our cap on the House side was $21,000.

Mr. **Woodward**. Right.

Chairman **Stark**. The Senate had some kind of a 90-percent business use and then, if you did not meet that, you were restricted to actual mileage.

Mr. **Woodward**. For business purposes.

Chairman **Stark**. Yes.

Mr. **Woodward**. Correct.

Chairman **Stark**. What is the rate there, in that one, do you recall?

Mr. **Woodward**. It is still the 20½-cents-a-mile rate. The Senate bill also increases the charitable mileage to a flat 12 cents a mile as sort of a compromise gesture.

Chairman **Stark**. With the reporting requirements that are the same?

Mr. **Woodward**. I am not sure.

Chairman **Stark**. What I am trying to get at is the areas on which you object. I understand your objection, as you stated, because the person has the car anyway. They are not buying the car to go to the Red Cross bandage session.

I guess I am trying to ask, is your objection more in the sense of that tax philosophy or do you see some widespread abuse and we could make this particular thing less objectionable by requiring stiffer reporting and making it a little easier for you to police?

Mr. **Woodward**. Well, I think that there are elements of all of those things. I think that, frankly, to my mind the revenue effect of this is probably No. 1 on the list, the question of whether the marginal incentive for additional charitable efforts is really worth the cost to the Federal Government that would be incurred.

There are possibilities of abuse under current law with the 9-cents-a-mile deduction and I doubt that doubling the mileage allowance or doing a little more than doubling it would give more incentive to make the claim.

Chairman **Stark**. I have to point out that this obviously inures to the benefit of your administration. My folks are the recipients of the charity. So, I try to do everything I can to help the administration here.

Mr. **Woodward**. There might be some further recordkeeping requirements imposed. I think, though, our basic objection is one of saying that there is a rationale for the difference. We think it is one that has merit, has been maintained for many years and I do not see a compelling case being presented to change it.

Chairman **Stark**. On H.R. 676, it is my understanding, if we eliminated or prohibited seller financing, and if all partners in the partnership had to be tax-exempt entities, and if we tossed in some restriction of making the acquisition of this property a purchase—in other words, so you could not, in effect, as you say, somebody could donate it when they cross over, they could donate cash. In other words, that the tax-exempt people would have a chance to purchase some leverage real estate but not play the game of getting the increased value and creating additional gaming.

Could we structure something that would minimize your objection?

Mr. **Woodward**. It certainly would minimize our objection. I think that we would also be very much interested in having those limitations be imposed on the pension-trust provision which is the model for this bill and, on balance I think that that would be——

Chairman **Stark**. If you added that, you would probably support it saying, you get two steps forward and one back?

Mr. **Woodward**. I think that we may be in that position.

Chairman **Stark**. Could I ask—if you know and if you care to testify—it is my understanding that there is at least one particular school, I believe it happens to be in Hawaii, where they are running elementary and high schools. They have some peculiar or particular reason for needing this to continue to either hold the real estate or develop the real estate they now own.

Are you familiar with this particular instance?

Mr. **Woodward**. I am generally familiar with that situation. It is my understanding that there is a trust or an estate—I think it is actually referred to as an estate—that owns a great deal of land in Hawaii and wishes to develop it through hotel and other types of development, and would like to contribute its land to the development effort and take back some interest in the overall operation.

Chairman **Stark**. Could they now do that if they just made a long-term land lease and had a participating lease? Would that be legal?

Mr. **Woodward**. Well, currently rents are not subject to unrelated business income tax. That was carved out when the rules came in because that was a traditional type of investment activity by charities. So, presumably it could do that.

Chairman **Stark**. This bill with some of the restrictions on seller financing, would its application, as far as you know, to that particular situation in Hawaii be objectionable? On a tax-policy issue, I do not mean to get you into——

Mr. **Woodward**. I believe that the representatives of the Hawaii estate have agreed to the provisions in the Senate bill, those types of restrictions. They do limit most or all of the kinds of abuses we can think of and presumably it would allow them to do what they want without giving us a problem.

Chairman **Stark**. There appears to be a series of restrictions or changes we could make, many of them incorporated in the Senate bill, that would minimize your objections, at least insofar as the Hawaiian case were concerned.

Mr. **Woodward**. That is correct, Mr. Chairman.

Chairman **Stark**. May I just inquire if the minority staff had any questions they wanted to submit?

Thank you very much.

Mr. **Woodward**. Thank you, Mr. Chairman.

Chairman **Stark**. Our first panel will consist of Alec Schwartz, staff director to the Special Committee on Prepaid Legal Services, the American Bar Association; William A. Bolger, executive director of the National Resource Center for Consumers of Legal Services; Nancy Gist, associate general counsel of Midwest Mutual Insurance Co. and director of Midwest Administrators, and Richard Scupi, United Auto Workers legal services plan.

Welcome to the committee and unless among you, you have some other plan, I would just call upon you in the order that you appear.

I gather we turn that light on, as we go. Please do not be intimidated by it, but it will help all of us to try and hold to the 5-minute restriction. There will be no electric shocks or cattle prods if the red light appears before you are finished.

Mr. Schwartz, would you like to proceed in any manner you are comfortable?

STATEMENT OF ALEC M. SCHWARTZ, STAFF DIRECTOR, SPECIAL COMMITTEE ON PREPAID LEGAL SERVICES, AMERICAN BAR ASSOCIATION, AND EXECUTIVE DIRECTOR, AMERICAN PREPAID LEGAL SERVICES INSTITUTE

Mr. SCHWARTZ. Thank you very much, Mr. Chairman.

My name is Alec Schwartz. I am appearing here today as staff director of the American Bar Association's Special Committee on Prepaid Legal Services. I am also the executive director of the American Prepaid Legal Services Institute which is an organization related to the ABA.

We have filed a written statement outlining in detail why we support H.R. 5361, and I would just like to make a couple of points briefly to emphasize why we are here today.

The ABA has supported the establishment of section 120 since the effort started in 1976 because we feel that prepaid legal service plans are of genuine benefit to employees across the country in that they provide access to needed personal legal services which allow employees to be productive and not be diverted from their attention to work because of legal problems.

Our board of governors has made the permanence of section 120 a legislative priority for 1984. We are convinced, after over 10 years of experimentation, including the period between 1976 and the present, that qualified group legal service plans work.

They provide the legal services which many employees can use to solve their personal, legal problems, and they do so at a very modest cost, without a demonstrated inflationary impact over the last 10 years, and without, we feel, much real revenue loss to the Government.

Plan benefits have been developed which promote the use of lawyers' services on a preventive basis. Access to legal advice by telephone makes it convenient to deal with many minor matters efficiently before they become serious legal problems involving extensive and expensive court proceedings.

I think that this feature is important. We know that the increasing burdens on our court system especially is drawing more and more public attention. By making it possible for an employee to get a lawyer early to ask a question or to have a problem resolved before it becomes serious, we know that an employee can stay on the job and out of court. Some of the other witnesses here today will be able to provide you with some firsthand testimony about this phenomenon.

Since 1976, the number of people covered under qualified group legal plans has grown from less than 100,000 to over 5 million today. Insurance companies have been convinced of the need to develop group legal service coverage as part of both conventional and flexible benefit offerings for employers and unions. Many of the plans in existence today have been stimulated by labor in recognition of worker needs.

We now have the necessary experience with these plans to make the evaluation that section 120 really does the job that it was designed to do: To stimulate employer-paid personal legal services; to have the plans operate in a manner which is both cost effective and which plans provide quality legal services; and to establish a mechanism which does not really cost the Government much in terms of money. On this latter point, we feel that these plans, in keeping people out of the courts, may in fact save State, local, and Federal Government money by reducing the load on our court system.

Finally, and I can say from my personal experience that I know that a legal service plan contributes to the productivity of workers because I have had some experience in my own office with employee legal problems. With the availability of preventive legal services the employer gains the productivity of the employee otherwise lost to involvement in time-consuming legal entanglements and State and Federal Government does not lose the tax dollars in wages that are lost when the employee has to go to court.

In summary, we support the permanence of section 120. We think it is essential. We think it is valuable. We think it has worked, and we think it is doing what Congress originally intended it to do when the legislation was passed in 1976.

Thank you very much, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ALEC M. SCHWARTZ ON BEHALF OF THE AMERICAN BAR ASSOCIATION

Mr. Chairman and Members of the Subcommittee: My name is Alec M. Schwartz. I am appearing here today on behalf of the American Bar Association. I am the Staff Director of the ABA's Special Committee on Prepaid Legal Services.

The ABA strongly believes that making Section 120 of the Internal Revenue Code permanent is of critical importance to millions of people throughout the country. Indeed our Board of Governors recently selected this matter as one of a small group of top legislative priorities for 1984. The bill introduced by you, Mr. Chairman, goes a long way toward achieving our goal, and the ABA fully supports its passage.

Section 120 determines the tax treatment of qualified group legal services plans. It provides that employees may exclude from their taxable income contributions made by an employer to such a plan and the value of any legal services received by the employee under the plan. I would like to state briefly why the American Bar Association has supported this tax treatment of employer-paid legal plans and why we feel that making Section 120 permanent is critical at this juncture.

Recognizing the need to develop mechanisms to help middle-income Americans gain access to personal legal services, the American Bar Association has worked for over ten years to develop and perfect the concept of prepaid legal services. In 1974, we joined with a coalition of labor, insurance, consumer and other groups to create an incentive for employers to provide legal services as a benefit for employees for much the same reason as they provide medical and other insurance benefits: to assure the personal well-being of employees and their families so that they can continue to be permanent and productive members of the workforce. If an employee is sick, he or she cannot work. Being ill in the workplace can greatly reduce productivity. By establishing tax incentives for employers to provide or pay for medical care, the Congress has recognized the economic benefits inherent in protecting an employee's physical health.

Legal problems can affect the emotional and financial health of employees. Financial problems often have legal implications. Falling behind in mortgage or loan payments can lead to wage garnishment and the possibility of eventual bankruptcy, both of which may involve not only the employee but the employer and the economy as well.

The incidence of these problems can have a significant effect on an employee's work productivity and can often lead to absences from work to go to court or otherwise deal with a problem personally. The following case study was compiled from actual cases in which what initially were minor personal problems led to serious personal and legal trouble:

Robert Simpson (fictitious name) worked as a quality control inspector at an electronics plant for six years. During that period, his performance evaluations were excellent and his attendance record perfect. Mr. Simpson was well-liked by his fellow employees and was credited with making a number of suggestions which markedly improved quality control procedures. He was active in his local union and was being considered by management for promotion to supervisor of his section.

In the seventh year of his employment, the quality of components coming off the assembly line where Mr. Simpson was stationed dropped off sharply. In addition, his attendance record began to deteriorate and he was absent from a number of important union meetings. Supervisors and co-workers tried unsuccessfully to ascertain the reason for this change in Mr. Simpson's behavior. He bacame short-tempered, explaining that he had a few minor personal problems he would take care of shortly. At one point, Mr. Simpson's job performance declined so much that both his coworkers and management feared that he might not only lose the chance for promotion but also his job as well.

Mr. Simpson's job performance suffered because he was distracted by serious legal difficulties. At the conclusion of his sixth year of employment, he moved his family to an older apartment building in a northwest suburb of the city. Simpson entered into a two-year lease, but did not consult an attorney as to the terms of the lease agreement. A month after the Simpson family moved in, a small fire broke out on the first floor of the building, and Mr. Simpson, who lived on the third floor, became concerned over the need for fire protection. The landlord refused to provide alarms and extinguishers, and Mr. Simpson, not the smartest of businessmen, decided to purchase $2,400 worth of fire protection equipment on an installment note.

Had Mr. Simpson talked to a lawyer before purchasing the equipment, he would have discovered that the landlord was obligated by both state law and municipal ordinance to provide fire protection equipment. He would also have been shown where the lease agreement he entered into specifically stated that the landlord would provide such equipment on request and that rent could be withheld if such a request was not honored.

Three months after the purchase of the equipment, Mr. Simpson discovered that he could not meet the installment payments. The finance company refused to listen to any excuses and promptly sued Mr. Simpson for $2,400 in municipal court. Mr. Simpson, unaware of the ramifications of the suit and without funds to retain a lawyer, failed to answer the complaint and a default judgment was entered against him. The fire equipment was repossessed and sold at a sheriff's sale for $400, with a deficiency balance of $2,000 showing as an unsatisfied judgment on the record of the court. Mr. Simpson was then summoned to court on a judgment-debtor hearing and his wages were immediately garnisheed.

Over the next six months, as Mr. Simpson attempted to pay off the judgment against him, his other monthly obligations fell into arrears. He lost his gasoline credit card, the rent was always late and his other creditors began harassing him for payment of his obligations. Several law suits were filed, all resulting in default judgments. Mr. Simpson attempted to secure a loan to relieve his financial burden, but loan companies refused to consider his application because of the court judgments.

Mr. Simpson became short tempered and abusive with his wife and children—a changed man with his family. Because of the change in him and the pressure of continual harassment by creditors, Mrs. Simpson informed her husband that she had had enough and filed for divorce. Simpson was served with the complaint at work, much to his embarrassment, along with motions for expense money, temporary alimony and support and custody of the children. Ironically, since the rent was once again late, the landlord filed for eviction. During the next six months, numerous hearings on the pending divorce were held and Mr. Simpson had little time for anything but the legal battles that surrounded him.

Could an attorney have prevented many of Mr. Simpson's problems? Probably. Certainly, an attorney's review of the original lease agreement might have prevented the credit purchase of the fire prevention equipment in the first place which seems to have led to many of his other difficulties. Even assuming that the purchase had been made anyway, many of the judgment-debtor problems could have been immediately relieved through the attorney's active participation with creditors. The divorce might well have been avoided if the credit problems had been alleviated initially. Even if the divorce was unavoidable, the availability of an attorney prior to the initiation of the suit by Mrs. Simpson could have prevented a lengthy contested proceeding.

Is this case atypical? We don't think so, though certainly many situations can turn out to be less disastrous. Let's take a "minor" matter which actually occurred in a midwest office.

An employee was billed by a hospital for approximately $130, which he thought he didn't owe and which had no money to pay in any event. Repeated requests for payment were ignored until the employee received a summons from a country court located 35 miles away from the office. The employee mentioned the need to take time out from work to go to court to his supervisor, who advised that the employee talk to a lawyer first. A lawyer was consulted and eventually accompanied the employee to court twice, requiring the employee to be absent from work for one-half day each time, and a settlement with payment arrangements was worked with the lawyer for the hospital.

The cost to the employee associated with this problem was calculated at $358.84, including $225 in attorney fees, $59.84 in lost wages, $28 in transportation to court and $46 in court fees. In addition, the employer lost the services of the employee for two mornings, the federal government lost approximately $11.80 in tax revenue on the employee's lost earnings and the hospital had to pay its attorney to handle the case in court.

The point of this story is that the attorney indicated afterward that had she been called as soon as the employee started receiving past-due notices from the hospital, she could have negotiated a payment schedule with the hospital by phone, avoiding the law suit, court appearances, costs, time off from work and the worry which had plagued the employee during the three months while this situation was developing.

How could an employer-paid legal benefit plan have helped in this second, more typical case? First, the employee, realizing that arrangements for consulting and paying for a lawyer were part of his compensation, would not have had to consider whether or not he could afford to hire an attorney. Second, by having this barrier removed, the employee would have had the incentive to consult a lawyer early, as soon as the problem presented itself, rather than waiting until the last minute and having a law suit filed against him. Third, the employer would not have lost the services of the employee both for the time taken to go to court and in the preceding months during which the employee's attention was distracted from his work because of worry and phone calls to and from the hospital.

Will employees actually take advantage of a legal services benefit to their own and the employer's advantage? The statistics we have gathered since Section 120 was enacted in 1976 indicate that they will. A comprehensive survey of the legal needs of the public published in 1977 by the American Bar Foundation and carried out by the National Opinion Research Center indicated that more than 35% of the population encounter problems each year that could be resolved by a lawyer, yet only 10% actually seek legal assistance. In contrast, our information indicates that an average of 20% of the employees covered by a group legal plan consult a lawyer at least once annually.

These employee-users are in a majority of cases receiving preventive legal assistance that often makes it possible to avoid litigation or other serious, protracted problems requiring substantial remedial services. Some of the newest prepaid legal plans feature legal advice and consultation by phone as a benefit. The administrators of these plans have told us that between 60% and 80% of the problems presented by plan members can be resolved over the phone in one or two calls or with telephone negotiation with adverse parties.

It is clear to us that after 10 years of experimentation with prepaid legal service plans, the promise that they hold for establishing a private-sector mechanism for delivering needed personal legal services to employees has been fulfilled. Direct tax revenue loss is considered minimal, as indicated in the March, 1983 estimates prepared by the staff of the Joint Committee on Taxation. Further, we suggest that tax dollars can even be saved by reductions in the use of our courts to resolve minor disputes as a result of preventive legal services being made available to employees through qualified group legal service plans. And the benefit to our economy of minimizing the impact of employee personal and legal problems on productivity in the workplace should not be taken lightly.

In 1976, Congress acted wisely in incorporating a termination provision in Section 120 which would force us to evaluate the efficacy of this tax policy in stimulating the development of plans which provide access to needed personal legal services. Further, controls built into subsection (c)(1) of Section 120 assure that qualfied group legal service plans will not discriminate in favor of highly-paid employees and wealthy owners of businesses, thereby insuring that middle-income Americans are the major beneficiaries of these plans. We are convinced that the plans have proven themselves, and we know that employers throughout the country are planning to incorporate legal service benefits into their compensation programs as soon as the taxation questions raised by the pending expiration of Section 120 have been resolved.

We urge that H.R. 5361 be passed into law at the earliest date possible so that the millions of employees who now take advantage of employer-furnished legal services can continue to do so and so that employers who have recognized the value of this benefit in maintaining good employee relations and productivity can move forward to implement a qualfied group legal service plan.

SUMMARY OF TESTIMONY OF ALEC M. SCHWARTZ, ON BEHALF OF THE AMERICAN BAR ASSOCIATION ON H.R. 5361

1. Many middle-class Americans fail to receive needed legal counsel when confronting legal problems, often with very serious consequences to the individual's well-being and productivity.
2. Employer-funded group legal services plans provide a mechanism by which middle-class workers can receive legal counsel and assistance, usually at a stage when actions can be taken to prevent serious problems developing.
3. Section 120 of the Internal Revenue Code has permitted group legal services plans to increase greatly in numbers in the past ten years; failure to continue its provisions would have a dire effect on these plans.
4. Direct tax revenue loss would be minimal and likely would be substantially offset by reduced demands on the courts and greater employee productivity flowing from preventive legal assistance.
5. For these reasons, Section 120 should be made permanent. H.R. 5361 goes a long way in achieving this objective and should therefore be enacted.

STATEMENT OF WILLIAM A. BOLGER, EXECUTIVE DIRECTOR, NATIONAL RESOURCE CENTER FOR CONSUMERS OF LEGAL SERVICES

Mr. BOLGER. Mr. Chairman, my name is William A. Bolger. I am executive director of the National Resource Center for Consumers of Legal Services.

The National Resource Center is a research and education organization working on legal services delivery issues. Our primary focus is on group legal services plans. We were founded in 1972 by consumer and labor groups and have closely followed legal plan developments for 12 years.

We strongly support section 120. I would like to stress here three points:

First, the efficiency of preventive law.

Second, the broad support enjoyed by legal services plans.

Third, the effectiveness of section 120 in stimulating the growth of plans at a minimal cost.

First, efficiency. Group legal service plans involve advance arrangements for meeting personal legal needs, especially for legal services that prevent or settle disputes. They have proven their ability to deliver high quality, low cost legal services. They are especially effective at preventive legal care, at avoiding or resolving problems without expensive litigation.

Legal service plans deliver more legal services at lower cost. Both society and the individual member benefit. How and why? Because the transaction costs are reduced when you make advance arrangements on a group basis. The advance arrangements dramatically reduce the time, the cost, and the uncertainty involved in selecting and consulting a lawyer when a legal question first arises.

Thus, people covered by a plan contact a lawyer more often, but at an earlier point in the course of a problem. More people receive legal advice about more matters, but the matters are handled at a lower cost and in a way that minimizes disputes and litigation.

Two, broad support. Group legal service plans are supported by the labor movement, the consumer movement, the legal profession, and the insurance industry. There is really no organized opposition to legal plans. They are in the best American tradition of pragmatic, voluntary group action to meet common needs.

Congress, too, has an unbroken record of supporting legal service plans, starting with the Taft-Hartley amendment in 1973, continuing with the enactment of section 120 in 1976, and finally its extension 3 years ago.

Three, the effectiveness of section 120—and that is really why we are here—we think it has proven its effectiveness in stimulating the growth of legal plans at a minimal cost and foregone revenue. About 10 million people are presently covered by a plan. The largest portion of these are in employer-paid plans covered by section 120. Yet, the 1983 revenue loss was just $25 million according to the Joint Tax Committee.

The reason the loss was so small is, the plans are very inexpensive. A study 4 years ago by the National Resource Center—and I might add that it was for the Labor Department and was meant to form part of the basis of their report to Congress—showed that the average employer paid plan costs $87 a year. At a 20-percent marginal rate of taxation, that is only a subsidy of $17.40 per covered family per year.

But that may overstate the cost because some of the new, big plans that have started up recently have a much lower cost.

Costs have increased little if at all over the years, and they should remain stable in the future because of increasing competition in the legal profession and the efficiency of word processors.

One final point. Because there are not any plan members or individual consumers scheduled to testify today, I thought it would be helpful to the committee to mention one good example of how plans benefit both consumers and society.

At a Senate hearing last month on section 120, Joseph Ruth described how his wife's membership in a legal services plan prevented their house from being stolen from them through fraud. Mr. Ruth's full statement is attached to my own written testimony. It is an intriguing and unusual story. Without the legal plan, they probably would have lost their house even if they had found a lawyer and won the case because they would have had to sell the house to pay their lawyer.

Mr. Ruth's case is not typical in its facts, but is typical in that having ready access to legal assistance enabled justice to be done.

The small cost in foregone revenue of that access to justice is a real bargain. Letting section 120 expire would undo a decade of work and dash the hopes of consumer, labor, and Bar Association leaders of all political persuasions.

Legal service plans have proven they meet a real and important social goal, that is, making legal services, especially preventive services, readily and inexpensively available to working Americans.

I would remind this body that Congress has to act on section 120 even to maintain the status quo, or over a decade of progress toward equal justice will be jeopardized.

Thank you.

[The prepared statement follows:]

STATEMENT OF WILLIAM A. BOLGER, EXECUTIVE DIRECTOR, NATIONAL RESOURCE CENTER FOR CONSUMERS OF LEGAL SERVICES

Mr. Chairman, my name is William A. Bolger. I am executive director of the National Resource Center for Consumers of Legal Services. The National Resource Center is a research and education organization working on legal services delivery issues. Our primary focus is on group legal service plans. We were founded in 1972 by consumer and labor groups, and have closely followed legal plan developments for twelve years. Our members include lawyers, insurance companies, benefits administrators and entrepreneurs as well as legal service plans themselves and the labor unions, consumer cooperatives and other associations that sponsor plans.

Mr. Chairman, the National Resource Center strongly supports section 120. Our position may be summarized as follows:

1. Group legal service plans have proven their ability to deliver high quality legal services at low cost. They are especially effective at preventive legal care—at avoiding or resolving problems without expensive litigation.
2. Group legal service plans are supported by the labor and consumer movements, the legal profession and the insurance industry. There is no opposition to legal plans. Plans are in the best American tradition of pragmatic, voluntary group action to meet common needs.
3. Congress has an unbroken record of supporting legal service plans, most recently in 1981 by extending Internal Revenue Code section 120 for 3 more years. Section 120 provides favorable tax treatment for employer-paid plans—including tough antidiscrimination rules—similar to that of other statutory fringe benefits. It is time now to make that section permanent.
4. Section 120 has proven its effectiveness in stimulating the growth of legal service plans at minimal cost in foregone revenue. About 10 million people are presently covered by a plan, the largest portion of these in employer-paid plans, yet the 1983 revenue loss was just $25 million, according to a report of the Joint Committee on Taxation.
5. Legal service plans have shown that they deserve equal tax treatment with other statutory fringe benefits.

Mr. Chairman, I would like to emphasize here to the Committee the broad support that legal service plans have earned, not just from consumers, but from all parties, to explain how that support developed and why it is justified, and to assess the impact of section 120 on the development of plans.

The Need for Legal Service Plans

A decade ago, evidence was mounting that a sizable proportion of the American population did not have meaningful access to legal services, and that there was reason to question whether "equal justice under law" was more fiction than reality. The subsequent study of legal needs conducted by the American Bar Foundation confirmed that two thirds of the population has needs for legal services that go unmet. Of these, half have either never seen a lawyer, or have seen a lawyer only once in their lives. While better than 35% of the population each year encounter problems that could be solved by a lawyer, only 10 percent actually seek legal assistance. By contrast, an average of 20 percent of the covered employees in a group plan seek legal services each year. These facts indicate that twice as many people obtain legal assistance in resolving everyday legal problems through participation in a group plan.

These employee-users, in the main, are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. Thus, group legal plans tend to preserve employee morale and productivity and assist in unblocking our overburdened judicial system.

What is it about legal plans that creates "win-win" situations, where everybody benefits? Basically, it is that transaction costs are reduced when advance arrangements are made on a group basis for providing needed legal services. Advance payment is not as important as advance arrangements that make legal services readily available. These advance arrangements dramatically reduce the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises. Thus people covered by a plan contact a lawyer more often, but at an earlier point in the course of a problem. More people receive legal advice, about more matters, but matters are handled at lower cost and in a way that minimizes disputes and litigation.

Since legal plans are a pragmatic solution to a real problem, it is no surprise that today's plans trace their roots to the early 19th century. Voluntary group action to meet common needs is an American tradition. However, it was only after a series of Supreme Court decisions in the 1960's established "meaningful access to the courts" as a First Amendment right that legal plans really developed. In the final case, *United Transportation Union* v. *Michigan State Bar,* 401 U.S. 576 (1971), Justice Black wrote for the Court:

> (T)he principle here involved cannot be limited to the facts of this case. At issue is the basic right to group legal action, a right first asserted in this Court by an association of Negroes seeking the protection of freedoms guaranteed by the Constitution. The common thread running through our decisions . . . is that collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the First Amendment. However, that right would be a hollow promise if courts could deny associations of workers or others the means of enabling their members to meet the costs of legal representation.

The Shreveport Plan, jointly sponsored by the Laborers' International Union, the American Bar Association and the Ford Foundation, began the same year—1971.

Congressional support

Congress' record of support for legal service plans goes back 11 years, when it determined that legal service plans provided through the private sector are a desirable mechanism for increasing citizen access to the legal system, and that legal service plans are an appropriate addition to the employee compensation system. The Taft-Hartley Act was amended in 1973 to allow the use of collectively bargained trusts to provide legal services. Within a year the first employer-funded collectively bargained legal service plans were established. In 1974, a further step was taken when Congress included legal service plans among the employee welfare benefit plans subject to Title I of the Employee Retirement Income Security Act. ERISA created a regulatory framework that allow legal service plans the freedom they needed to experiment and to thrive.

Congress also determined, in 1976, that legal service plans would neither develop nor grow without certain changes in the tax code to put nondiscriminatory legal plans on a favorable tax footing along with other employee fringe benefits. Accordingly, Congress included in the 1976 Tax Reform Act a new section 120 of the Internal Revenue Code. This provision clarifies the tax status of prepaid legal service plans by providing explicitly that:

(a) Employer contributions to qualified prepaid group legal service plans on behalf of an employee do not constitute income to the employee; and

(b) The value of legal services provided under a qualified prepaid group legal service plan does not constitute income to the employee.

At the same time, Congress created Section 501(c)(20) providing for tax-exempt trusts through which legal service plans could operate.

Because of the experimental nature of the plans in the mid-1970's, Congress made section 120 temporary in order to provide an opportunity to reexamine the effect of section 120 on the plans in the light of actual experience. In 1981 Congress extended section 120 for three years, and it now falls on the 98th Congress to make section 120 a permanent part of the Code. The National Resource Center firmly believes that legal service plans have proven their value beyond all doubt, and that Congress has no reason to reverse the judgments of the last 6 Congresses.

A Profile of Operating Legal Service Plans

Employer-funded legal service plans are the largest category of plans. The National Resource Center estimates that of the ten million people presently covered by a plan, the largest portion are in an employer-paid plan. These plans include both collectively bargained plans and plans funded unilaterally by employers. While the collectively bargained plans range considerably in size, from fewer than 100 people to 1.4 million, the unilateral employer plans are all small. Collectively bargained plans thus account for almost all the employees covered by employer-funded plans. Almost all major international unions, and some independent locals as well, have members covered by collectively bargained plans.

Section 302(c) of the Taft-Hartley Act stipulates that collectively bargained prepaid legal service plans may not be used to sue either the employer or the union, nor may they be used to defend union officials charged with violations of certain federal labor statutes. Most collectively bargained plans are required to be jointly administered by trustees selected by the employer and the union. Legal service plans established unilaterally by employers are treated just like any other employee welfare benefit plans and must meet the reporting disclosure and filing requirements of ERISA.

Numerically, the other important category of employment-related plans are those funded unilaterally by unions. The National Resource Center's clearinghouse documents suggest that up to one million people may be covered by these plans. These as a First Amendment right that legal plans really developed. In the final case, *United Transportation Union* v. *Michigan State Bar,* 401 U.S. 576 (1971), Justice Black wrote for the Court:

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Numerically, the other important category of employment-related plans are those funded unilaterally by unions. The National Resource Center's clearinghouse documents suggest that up to one million people may be covered by these plans. These plans are not directly affected by section 120 since they are not employer-funded, but they are usually viewed by the unions as experimental plans that they hope to convert to employer funding in the future. Graphs including the above figures are appended to this statement as Appendix A.

Plans exist in every region and nearly every state in the country. They are most prevalent in major metropolitan areas.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on, depending on the level of plan funding. (Where the plans are funded by a union, job-related legal services such as defense of civil suits—against police or teachers, for example—are often also included.) Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered than felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matters are covered. Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is also frequently provided.

Because of the potential impact of plans on the private bar, there has been considerable interest over the years in the way in which legal services are delivered. Today we have the benefit of over ten years experience with all types of delivery systems, and it is clear that each system has advantages that make it the system of choice in certain situations.

Although legal service plans fill a real and important need, their cost is very modest. The cost of legal service plans has not changed much over the years. Today a plan that provides unlimited telephone advice and consultation with an attorney, some limited follow-up and reduced fees for additional services cost between $15 and $60 per family per year. A reasonably comprehensive legal service plan costs between $70 and $250 per family per year. Plans tend to provide more limited benefits initially using whatever monies are available, then expand services gradually when more funds are available. It is difficult to imagine the cost of legal service plans rising dramatically. The average person has a real need for legal services that now generally goes unmet—but those legal needs can be satisfied inexpensively through a legal service plan.

Revenue loss

In 1983, seven years after they were recognized in the Code, the revenue loss allocable to qualified group legal service plans was just $25 million, according to the Joint Committee on Taxation. I think you'll agree that's not very much, by Federal budgetary standards anyway. A study 4 years ago by the National Resource Center found that the average employer-paid plan cost $87 per year. At a 20% marginal rate of taxation, that's a subsidy of $17.40 per covered family per year. But even this may be overstating the cost. In 1981 the UAW-Chrysler plan, then the second largest plan and the only truly nationwide prepaid plan, cost just $30 per year. The cost to the Treasury was about $6 per family. Similarly, the huge new UAW-General Motors plan covering 1.4 million people is funded at just 3¢ per hour. That contribution of about $40 per employee per year covers families, retirees and their families, and recently laid off workers as well.

One good example

Because there are not any individual plan members or consumers of legal services scheduled to testify today, I thought it would be helpful to the Committee to conclude with one good example of how plans benefit consumers and society.

At a Senate hearing last month on section 120, Joseph Ruth described how his wife's membership in a legal services plan prevented their house from being stolen from them through fraud. Mr. Ruth's testimony is attached as Appendix B. It's an intriguing and unusual story. Without the legal service plan, they would probably have lost their house even if they won the case, because they would have had to sell to pay their lawyer. Mr. Ruth's case is not typical in its facts, but is typical in that having ready access to legal assistance enabled justice to be done. The small cost in foregone tax revenue of that access to justice is an incredible bargain.

Conclusion

Letting section 120 expire would undo a decade of work and dash the hopes of consumer, labor and bar association leaders of all political persuasions. Legal service plans have proven they meet a real and important social goal: making legal services, especially preventive services, readily and inexpensively available to working Americans.

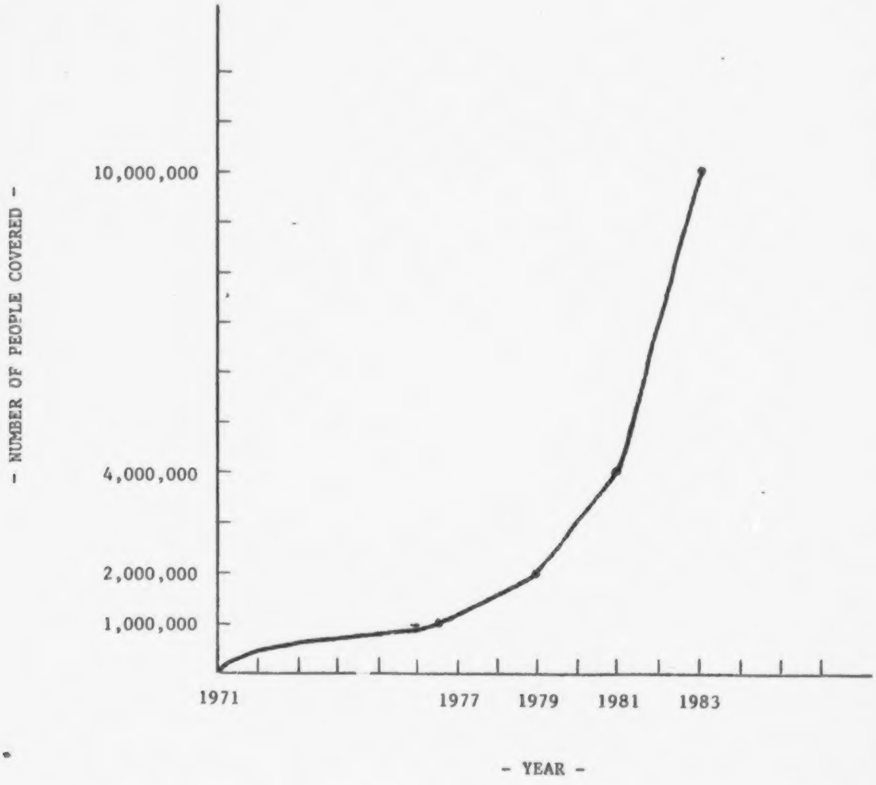
Congress must act on section 120, even to maintain the status quo, or a decade of progress toward equal justice will be jeopardized.

APPENDIX A

AGGREGATE LEGAL SERVICE PLAN STATISTICS:

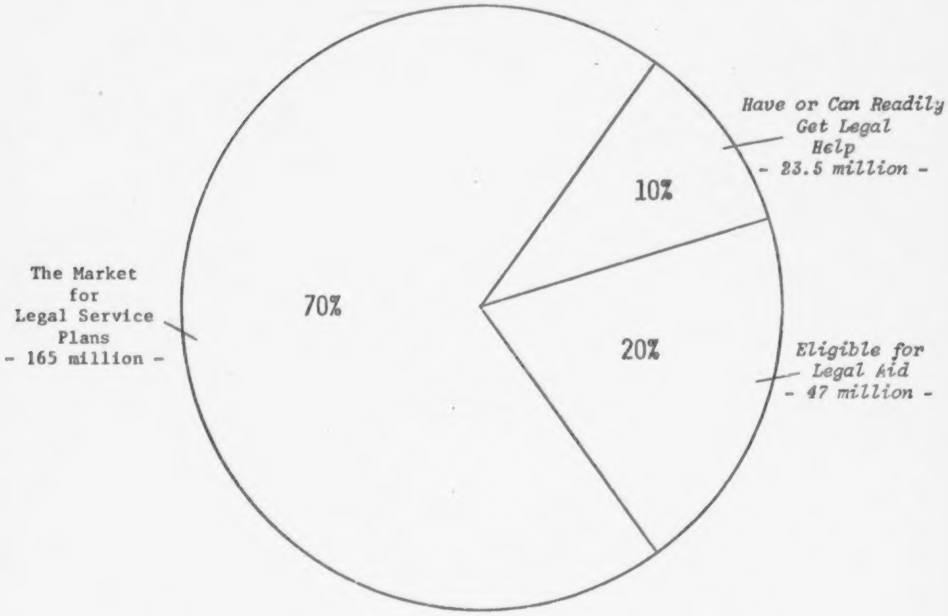
GROWTH - MARKET PENETRATION - LEGAL NEEDS - PLAN TYPES

1. GROWTH - NUMBER OF PEOPLE COVERED BY A PLAN IN THE UNITED STATES (INCLUDES FAMILY MEMBERS)

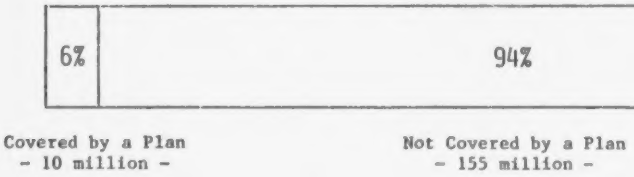


2. MARKET PENETRATION

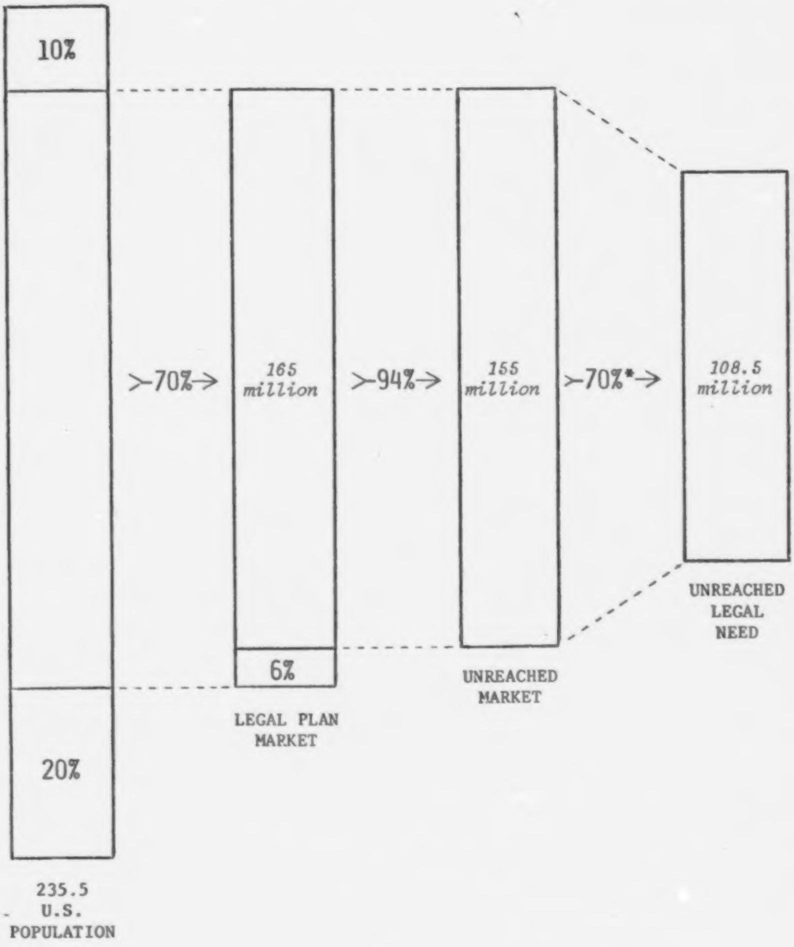
235.5 MILLION PEOPLE IN THE UNITED STATES



LEGAL SERVICES PLAN MARKET
- 165 million people -



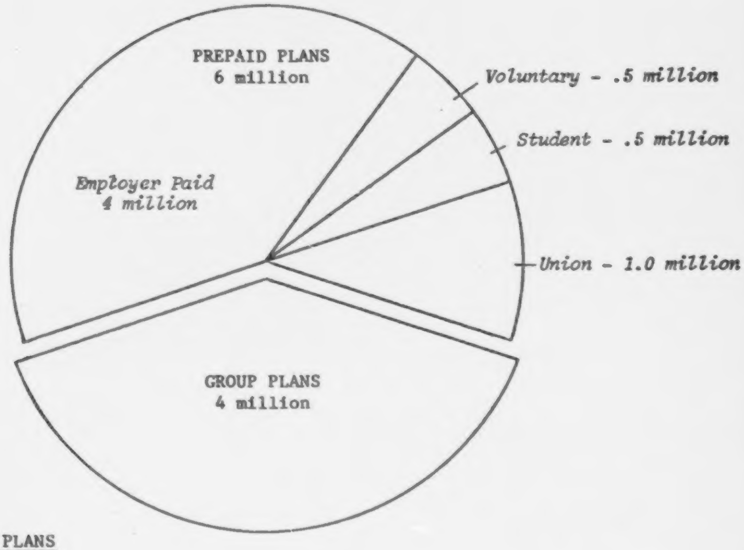
3. LEGAL NEEDS


10%
20%
235.5
U.S.
POPULATION
>-70%->
165
million
6%
LEGAL PLAN
MARKET
>-94%->
155
million
UNREACHED
MARKET
>-70%*->
108.5
million
UNREACHED
LEGAL
NEED

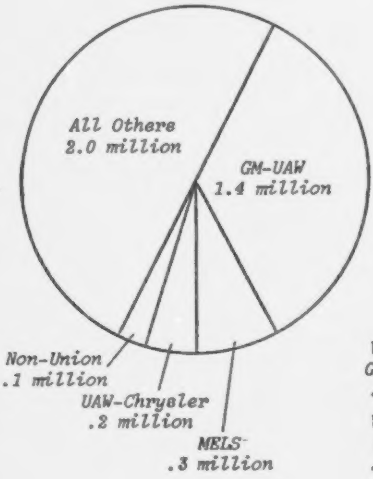
* Per Curran Legal Needs Study

4. PLAN TYPES

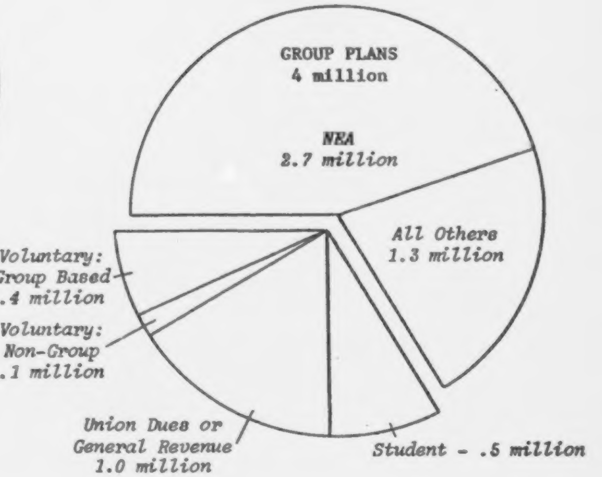
ALL PLANS
10 million people



EMPLOYER PAID PLANS
4 million



OTHER PLANS
6 million



APPENDIX B

STATEMENT OF JOSEPH RUTH, WASHINGTON, DC

1. Through the legal services plan of Local 25 of the Hotel and Restaurant Workers Union I was able to obtain a lawyer and prevent my house from being stolen from me through fraud.

2. Without the plan I would probably have lost the house even if I had won the case, because I would have had to sell the house to pay the lawyer.

3. Legal services plans are a great thing and you should make sure they can continue.

Mr. Chairman, I am Joseph Ruth. I live at 1449 S St., N.W., Washington, D.C. I was asked to appear today as a sort of representative of the 10 to 12 million Americans who are covered by a legal services plan. My own case was rather unusual, but I think it illustrates just how valuable these legal services plans can be.

About eight years before my mother died, that would have been about 1970, my wife and children and I moved in with my elderly mother into her house on S St., the one where we now live, in order to care for her. She was beginning to be unable to keep up the house and it was unsafe for her to live alone. We gave up our own place in Southwest.

Mother got cancer in about 1974 and grew increasingly sick until she died in 1978. For the last two years she required constant care, which was provided solely by me, and by my wife and daughter. Mother was very disappointed that my 4 brothers and 3 sisters had so little contact with her even though most remain in the area. They almost never visited her, especially after she became ill. She told them that she intended to leave the house to me so that we could continue to live there, and she made a will saying so.

Within a few days of her death my brother Luther produced a typewritten will, dated later than the one I had, that left the house to him on the understanding that it should be sold and the proceeds distributed among all her children. I was shocked. The signature looked like hers, but I was sure it was not her genuine will. It was contrary to everything she had told my wife and me. To our knowledge my brother had not even visited her during the period when the will was made. (He later claimed to have visited her, with the witnesses, while we were all out.) I consulted a couple of lawyers and came away dismayed. They wanted a big deposit before they would do anything, bigger than we could obtain. They explained that contesting a will was expensive. It was hard to prove and would take considerable time. The worst part was that even if we won we probably would have had to sell the house to pay the fee. You see, the house was about all my mother had, and my wife and I are not wealthy. I work in the kitchen at the Capitol Holiday Inn and my wife is a member of Local 25 of the Hotel & Restaurant Workers Union.

That saved us! My wife remembered that they had legal help available and inquired about it. In December 1978 we met with attorney Paul Regan of Robert Ades and Associates. We found that the legal services plan would cover my case and would pay the legal fees. You can imagine how relieved we were. We knew we were right, but were afraid we would lose our place to live anyway.

Once Mr. Regan got started on the case we felt good about it. He was great. He interviewed lots of people, got a handwriting expert, and everything. It took quite a while before the trial, but Mr. Regan always knew just what to do. I thought the others would give up, but they didn't. One brother refused to join in the fraud, but the others did.

It's very hard to explain just how painful it was to hear my own brothers and sisters lying like they did. It was one of the worst days of my life. It would have been worse if they had gotten away with it. We won the case, and I haven't spoken to most of my siblings in the two years since. No criminal charges were brought against them.

Thanks to the legal services plan of Local 25 and the excellent work of Mr. Paul Regan, we're still in our house, my mother's wishes were followed, and justice was done. Without the plan we probably would have lost the house even if we had fought against the fraud. At the very least we would be paying off a big loan secured by the house.

As I said earlier, I know my case was very unusual, but I know there must be many, many other people who would be spared much heartache and money by having a lawyer to represent them. I hope you will continue the law that makes legal service plans like Local 25's possible.

Thank you very much for inviting and listening to me.

Chairman STARK. Thank you, Mr. Bolger.

Ms. Gist.

STATEMENT OF NANCY GIST, ASSOCIATE GENERAL COUNSEL, MIDWEST MUTUAL INSURANCE CO., AND DIRECTOR, MIDWEST ADMINISTRATORS

Ms. GIST. Thank you, Mr. Chairman.

I am associate general counsel of Midwest Mutual Insurance Co. We have been underwriting and administering group legal services plans for 10 years and now cover more than 80,000 families nationwide.

Almost all of our plans are employer-funded true groups, and that gives us the bargaining power to get attorneys to agree to our fee schedule and to accept plan payment as payment in full for the services that they provide.

By being able to make these arrangements, we removed one of the main obstacles that working people face in trying to or hoping to or needing to obtain legal services, as identified by an American Bar Foundation study. That is the uncertainty and fear that they face as to what the fee is going to be and whether it will, in fact, be affordable.

Legal services plans also generally identify attorneys for plan members, thus removing another major obstacle, which is that most working people have not used a lawyer before, or perhaps once, if at all, when they bought a home, for instance, and do not know how to find an attorney who is suitable to handle the matter that they are facing.

More than 60 percent of the plan members who use the services available to them have never contacted a lawyer before, never consulted one, and are now able to seek the assistance they need in a timely manner. The elimination of these two barriers alone has immeasurably increased access to the justice system for members of employer-paid legal services plans.

There are also advantages from the employer's point of view. It has been demonstrated that productivity can be increased by the introduction of a legal services plan. Many of the problems workers have, which require them to miss work or require, for example, the employer to be involved in the garnishing of wages, could be avoided with the timely legal counseling which is available and encouraged through group legal services plans. And those which do get out of control can be minimized with the prepaid representation that these plans provide.

In connection with costs, I would like to make the point that the premium for our basic family plan is the same as it was 10 years ago. We have achieved this in large part through the bargaining power that we have been able to obtain with large employer groups, as a result keeping attorneys' fees down, has enabled us to keep our premiums down.

There is one other point I would like to make in connection with one of Mr. Woodward's assertions, if I understand him correctly. We cover groups ranging from office workers and supermarket clerks to teachers and airline pilots, and in a given geographic location a will, a bankruptcy, or an adoption done for an airline pilot, has the same value as a will, a bankruptcy, or an adoption done for a clerk, because the attorney is paid the same amount under the fee schedules we use and that our other collegues in other plans use.

That is the beauty of the bargaining power which we can achieve with these large employer-paid true groups. Since most plans have scrupulously avoided the use of the usual customary and reasonable standard of the fee for service system employed in health care, there just is not that kind of variation between the costs of services.

Based on our experience, there really is no validity to the assertion that there would be a greater exclusion for those with greater income. But of course, we have not yet had the benefit of the data that is supposed to have been collected. So, we can only talk on the basis of our experience.

Let me say in conclusion that we are joined in our support of this legislation by a half dozen other major insurance companies to provide access more widely and to eliminate the barriers which have traditionally prevented working people from meaningful access to legal services, the extension of section 120 is imperative. There is no rational basis that we are aware of for treating legal services differently from any other fringe benefit.

Thank you.

[The prepared statement follows:]

STATEMENT OF NANCY GIST, ASSOCIATE GENERAL COUNSEL, MIDWEST MUTUAL INSURANCE CO. AND DIRECTOR, MIDWEST ADMINISTRATORS, INC.

SUMMARY

1. Most middle income, working Americans are at once victimized by and effectively excluded from our legal system; they go unrepresented, unadvised and underprotected.
2. There is a demonstrated relationship between a worker's physical well-being and job performance, and legal problems she or he may have; employer funded legal services plans, which this legislation would encourage, can increase productivity and reduce lost time.
3. The escalation of costs which has occurred in health care services is unlikely to occur with legal services.
4. True-group arrangements, generally employer paid, serve to provide plans with the bargaining power which makes it possible to minimize fees paid to attorneys through the plans.
5. Many insurers are prepared to offer a group legal services benefit, yet most have chosen not to undertake major marketing efforts which would make group legal services more widely available while the status of IRC Section 120 is uncertain.
6. Midwest Mutual Insurance Company and Midwest Administrators, Inc., are joined in their strong support of H.R. 5361 by The John Hancock Mutual Life Insurance Company, The Equitable Life Assurance Society of the United States, the Prudential Insurance Company of Amercia, Aetna Life and Casualty Company, Connecticut General Life Insurance Company, Bankers Life and Casualty Company and Bankers Life of Nebraska.

Mr. Chairman, my name is Nancy Gist. I am associate general counsel of Midwest Mutual Company and director of its administrative and consulting subsidiary, Midwest Administrators, Inc. Midwest Mutual has been writing group legal insurance for ten years; Midwest Administrators consults with and provides administrative services to group legal plans and plans in formation. We currently cover over 80,000 families nationwide.

Midwest operates group plans ranging in size from eight to 15,000 members in 35 states, using a variety of funding mechanisms (employer-paid; dues funded; voluntary enrollment member paid; cafeteria) with benefits provided through a number of delivery systems (telephone access; closed panel; contracting attorney and indemnity option arrangements). Plan members include police and firefighters, truckers, teachers, state and municipal workers, credit union members, laborers, retirees, office workers and auto workers. Many of these plans offer a broad range of services including advice, will drafting, defense in civil matters, adoptions, representation in consumer and debtor/creditor matters, traffic problems and the sale or purchase of a residence.

Plan sponsors report almost uniform satisfaction of their members with services received, and that without the plan, their members would probably not have sought or obtained help. And we do all of this at premiums ranging from $12 to $125 per family per year.

Midwest Mutual's annual premium for its comprehensive family policy, $103.80, is the same today as it was in 1974. Our experience reflects the trends in legal services plans generally; premiums have remained level or have been decreased, or benefits have been added for the same premium.

Insurers and others planning and operating group legal services plans are acutely aware of the experience in health care, and most have steered clear of the notorious fee-for-service, and even UCR (usual, customary and reasonable) standards in favor of requiring contracting attorneys to accept a fixed plan payment as full payment for services provided. In fact, the health care industry has recently begun to adopt payment mechanisms and delivery systems (like Preferred Provider Organizations and Health Maintenance Organizations) which have been widespread in legal services from the beginning.

A critical aspect of minimizing payments to lawyers for services provided is plans having the bargaining power to get lawyers to agree to a schedule for payments. True groups, usually employer-funded, hold the promise for lawyers of a pool of potential clients from which they may receive a sufficient volume of new business that they are willing to accept a reduced fee. Other factors contributing to lawyers' willingness to accept reduced rates are lawyer advertising and the virtual glut of lawyers, which are creating competition helpful to stabilizing fees. In any case, group legal services plans can play a role in protecting attorneys' fees from the escalation associated with health care fees.

Employer funded legal services plans can increase productivity, reduce lost time and improve worker morale. A Fortune 500 manufacturer, considering the purchase of a group legal services plan from Midwest Mutual, asked the head of its employee counseling department to evaluate the program. He did, and recommended it as an employee benefit. He said he found that thirty percent of the problems the employees brought to him were actually legal problems, or had legal problems as a root cause. He projected that, in terms of increased productivity alone, the company could save $30,000 to $90,000 per year even after paying the premiums for its 12,000 workers.

Court appearances and other legal entanglements take away from workers' valuable working time. Most of these can be avoided with the timely legal counseling which is available and encouraged through group legal services plans. Those which do get out of hand can be minimized with the prepaid representation such plans provide.

Workers' unattended credit problems and the resulting garnishments mean expense for the employer. Suspension of a worker's license to drive can mean that he or she does not even get to work. These and other legal complications can lead to the loss of trained personnel; they can be forestalled when legal services are readily available to workers.

Besides the cost in time and money, legal difficulties take an emotional toll that affects productivity and safety on the job. Group legal services plans alleviate this burden by guaranteeing the workers have professional protection against the unexpected without financial strain.

Group legal services plans promote efficient use of legal resources by providing plan members with the opportunity to obtain legal advice and assistance sooner rather than later, before rather than after the fact. The real emphases of these programs are access and prevention. These plans make it possible for members to avoid litigation or serious problems requiring substantial "legal care" by eliminating the barriers to obtaining timely advice. Clearly the costs of having an attorney review a plan member's contract before it is signed are far less than the costs of that attorney representing the member in litigation relating to that contract later. The value of the preventive aspect of group legal services plans cannot be overstated.

Midwest Mutual Insurance Company and Midwest Administrators, Inc. are joined in their strong support of H.R. 5361 by The John Hancock Mutual Life Insurance

Company, The Equitable Life Assurance Society of the United States, the Prudential Insurance Company of America, Aetna Life and Casualty Company, Connecticut General Life Insurance Company, Bankers Life and Casaulty Company and Bankers Life of Nebraska. These and other companies across the country have monitored the development of group legal insurance for as many as twelve years, but the temporary nature of the tax exempt status of this benefit has discouraged most from actively entering the market.

Since the first pieces were passed in Texas, North Carolina and California in 1975, the states have continued to enact legislation which would enable insurance companies to write legal insurance policies. Policies can now be filed in all states but one, Maine, where hearings were recently held on enabling legislation. The number of companies nationally filing for and obtaining approval of policies in one or more states has increased 500% from three years ago, yet most will not undertake major marketing efforts which would make group legal services more widely available until the status of IRC Section 120 is clear.

Our years of experience with these has made it clear that middle income, working Americans are at once victimized by and left out of our system of justice. They go unrepresented, unadvised and under-protected through the tangle of courts, agencies, ordinances, regulations and statutes which have increasingly complicated our society. They work, buy cars and refrigerators, take vacations, buy and sell homes, pay tuition, borrow money, sign installment contracts, get traffic tickets, and try to make ends meet, too often unaware of their rights, not knowing that these actions have legal consequences, concerned about the cost of consulting or involving a lawyer, and obtaining representation only at the last minute, if at all. Effective access to the necessary legal services, guidance, and representation can make a difference in the quality of their lives.

Employer funded plans can help make the ideal of equal access to justice, in its many guises, a reality for many Americans, regardless of their economic class. Their immediate legal needs can be met effectively and inexpensively through such plans. Extension of IRC Section 120 through enactment of H.R. 5361 is imperative to these ends.

Chairman STARK. Thank you very much.

Mr. Scupi.

STATEMENT OF RICHARD SCUPI, DIRECTOR, UAW-GM LEGAL SERVICES PLAN, AND UAW LEGAL SERVICES PLAN

Mr. SCUPI. Yes, Mr. Chairman, thank you.

I am here on behalf of the prepaid legal services programs that UAW has negotiated with Chrysler, General Motors, and American Motors.

These programs have all been negotiated by UAW as a pretty direct result of the enactment of section 120. These programs are attractive to employers, which in a collective bargaining context probably means they resist them very little.

The reasons are that they have remarkable low costs and flat costs over time. There are several reasons for this. Of course, it is a buyer's market for attorneys these days. Legal services can be very efficiently and cost effectively delivered in this type of context where both the incentive to be efficient and the delivery system to permit that can be established.

All of the programs that UAW have negotiated have a delivery system that is akin to the HMO model in the health care area. That is one of the reasons they are attractive to employers.

The main point I would like to make here is that these plans have demonstrated that the access of working Americans—and as you know, UAW members are in the income range of about $20,000 to $25,000 annually in the auto industry—the access of this group of Americans is enormously enhanced to the justice system here.

The benefits that these programs have were deliberately designed to enhance access to legal services. In the legal problems where a lawyer would be acquired in any event, such as in a divorce, the benefits of the programs are relatively limited. It is in the areas where UAW saw that their members with greatest needs were not using the justice system because they were unable to, the benefits here are the broadest. That is in what we call the consumer area and the debt area.

These programs were negotiated by UAW with the knowledge that from time to time a great many of their members are out of work and have serious debt problems. The broadest benefits for these programs are in that area. That is, the full cost of legal services in the debt area, in the consumer area, are provided by the programs. In most other areas, the full cost of legal services are not covered by the program but just 1, or 2, or 3 hours of legal services are paid by the program and the rest is paid by the client—as in divorces, for example.

The priority in establishing these programs was to permit access by UAW members to the justice system in those areas where they could not use it because of economic reasons. I think these programs have demonstrated that the intent of the parties that established this program have been accomplished.

Attached to my written statement is a summary of the types of cases that were handled in 1983, and you will see the enormous number of cases that came in, in what we call the consumer and the debt area. And that was a relatively good year for UAW members working in the auto industry.

For these reasons, these programs and the trustees of these programs strongly support the continuation of section 120.

[The prepared statement follows:]

STATEMENT OF RICHARD SCUPI ON BEHALF OF UAW-GM LEGAL SERVICES PLAN AND UAW LEGAL SERVICES PLAN (CHRYSLER HOURLY EMPLOYEES)

SUMMARY

1. Since Section 120 was enacted, UAW and Chrysler, UAW and General Motors, and UAW and American Motors have negotiated prepaid Legal Services Plans for the benefit of employees of these companies represented by UAW, and for retirees.
2. These legal services plans are of great benefit to the participants of the plans. Access to the legal system is greatly enhanced by these programs.
3. These plans all have an HMO model for providing benefits in order to maximize controls over quality and cost of services.
4. The cost of these programs is quite modest. In 1983 the cost of the programs was about $40 per employee—and this sum funded the provision of benefits to retirees also.
5. Section 120's continuance is essential for large groups to continue, or start such programs.

STATEMENT

Mr. Chairman and Members of The Subcommittee: My name is Richard Scupi. I appear today on behalf of the UAW-GM Legal Services Plan and the UAW Legal Services Plan (U.S. Chrysler Hourly Employees) to testify in strong support of H.R. 5361, a bill to extend Section 120 of the Internal Revenue Code for 5 additional years.

We all recognize that the judicial system plays a central role in our society. This means that in order for Americans to fully participate in their society, they must have full access to the judicial system. Increasing awareness of this point created significant interest in prepaid legal services as an employment fringe benefit. In

1976, Congress recognized this interest by enacting Section 120 of the Internal Revenue Code for a five-year period.

Enactment of Section 120 was an important breakthrough, as it permitted collective bargaining for prepaid legal services. UAW took this opportunity to establish a model prepaid legal services program on a national basis. In 1978 the UAW Legal Services Plan (U.S. Chrysler Hourly Employees) received the first 501(c)(20) ruling from the IRS. By late 1978 the UAW Legal Services Plan was operational.

Because the goal of this first program negotiated by UAW was to provide its Participants with high quality legal services in as economical and efficient a manner as possible, the Plan employed a benefit delivery system akin to the HMO model in health care, permitting the maximum degree of control over the cost and quality of the legal services provided by the program. The Plan selects, employs, trains and supervises the salaried full-time attorneys who provide legal services. The Plan organizes and systematizes the practice in the offices out of which these attorneys work. Plan offices have established in areas where a significant concentration of eligible Participants live and work. About 85% of those eligible for benefits under this program receive services from Plan offices.

In areas where there are not a sufficient number of employees and retirees to warrant establishing a Plan law office, a Cooperating Attorney system was developed to provide benefits. The Plan selected and contracted with attorneys in private practice to provide services to Participants referred to them, to bill the Plan and/or client at specified rates for specified services and to provide the Plan with reports as to each case handled. Participants are referred to Cooperating Attorneys after calling on a toll-free number to the Plan's administrative offices in Detroit so that the referral made is for a specified matter in the fee schedule.

Now in its sixth year of operations, the UAW Legal Services Plan (U.S. Chrysler Hourly Employees) has handled about 90,000 cases for Chrysler employees, retirees, and their dependents. The program also served as a model for future collective bargaining. After Congress extended Section 120 for an additional three years in 1981, UAW and General Motors Corporation negotiated a comparable legal services program. In April 1983, the UAW—GM Legal Services Plan became operational. By the time this program completes its first year of operations at the end of this month, about 85,000 cases will have been opened for Plan Participants. The benefit delivery system for the UAW-GM program is essentially the same as that established by the program for Chrysler workers and retirees.

UAW has negotiated additional legal services programs. In October 1983 a program began serving Chrysler salaried employees and retirees who were not covered by the original Chrysler program. In April 1984 a program for some American Motors Corporation employees and retirees began to provide benefits. These programs have been modeled upon the GM program to a large extent.

The existence of all of these programs and their ability to establish the delivery system being employed is clearly dependent upon the existence of Section 120 of the Internal Revenue Code. The parties who collectively bargained these legal services programs would not have done so without the tax provisions placing legal services on a par with other, older fringe benefits.

These programs now have law offices in the following States: Michigan, 16 offices; Ohio, 12 offices; Indiana, 6 offices; New York, 5 offices; Missouri, 4 offices; Wisconsin, 3 offices; Georgia, 2 offices; Illinois, 2 offices; Maryland, 2 offices; New Jersey, 2 offices; Alabama, 1 office; California, 1 office; Delaware, 1 office; Kansas, 1 office; Louisiana, 1 office; Massachusetts, 1 office; Oklahoma, 1 office.

In many additional States, there are thousands of persons receiving benefits under these programs from Cooperating Attorneys in their communities.

Enhancing access to legal services is the primary objective of the several programs negotiated by UAW. The benefits of the programs emphasize access to attorneys for office work for most legal problems. The operations of the programs emphasize access to attorneys by telephone for advice and consultation. While the decision of a UAW member or retiree to seek legal counsel remains an individual decision subject to many considerations, these programs greatly enhance the accessibility of lawyers to any Participant seeking counsel.

These programs have proven of great value to their Participants. Some illustrative statements received on questionnaires sent out after cases are closed are as follows:

A worker in Buffalo, New York wrote: "I feel that this program allows a person to pursue legal remedies to problems that would be financially prohibitive under most circumstances. We are no longer at the mercy of those who can easily afford an attorney!"

A Tennessess worker wrote: "I think UAW and GM did a wonderful thing when they set up this Legal Services because some of us are just not able to pay what the attorneys charge today. We have used this program twice and it has saved us money, and provided complete information and assistance."

A Michigan retiree wrote: "I believe the UAW-GM Legal Services Plan provides a vital service to retirees, who otherwise would not be able to afford even such a small item as a common will. This Plan is also a Godsend to the total and permanent disabled of General Motors and the UAW.

An Arizona retiree wrote: "I had been putting off having a will drafted for months.

Your notice of legal services came at an opportune time. Thank you very much for this service. I hope it is not needed again, but if it is, I will doubly appreciate it."

An assembly line worker from Illinois wrote: "I think this program is a wonderful program for those of us who make too much money to qualify for the poor class and not enough to say we are rich."

A retiree from Florida said: "[I think] this is a very good thing for the retirees—they have to live on a small pension and can't afford the expense."

The cost of these programs is modest indeed. We estimate the annual cost per eligible worker of these programs is currently about $40—and this cost also provides the benefit to over 200,000 retired workers and their dependents. For example, the UAW-GM Plan's funding formula provides 3¢ for each straight time hour worked to provide benefits for workers, retirees, workers laid off for one year or less, and the dependents of each group.

Exhibits have been attached to this statement showing the modest yearly operating costs of the program for Chrysler hourly workers and retirees, and the types of legal problems which were handled during 1983.

While these programs are still relatively new, as is Section 120, we believe they promise much for the future. Prepaid legal services programs for groups such as UAW members carry with them the promise for fulfilling one of the great dreams of our democracy under the rule of law—to give each citizen not only equal rights but the means to pursue and defend them as vigorously as necessary to see that the equal rights are realized in practice as well as in theory.

In order for these programs to continue, and for others like them to get started, the enactment of H.R. 5361 is required.

UAW legal services plan (U.S. Chrysler hourly employees) cumulative expenditures as of Sept. 30, 1983

1978	$1,103,906
1979	3,571,635
1980	3,844,444
1981	3,279,027
1982	3,206,168
1983	2,198,839
Total	17,204,021

UAW-GM LEGAL SERVICES PLAN, UAW LEGAL SERVICES PLAN (CHRYSLER HOURLY EMPLOYEES)

Cases opened by problem type in 1983	Count	Percent
Wills	14,695	16.23
Probate	1,767	1.95
Taxes—estate, inheritance	94	.10
Civil commitment	70	.07
Guardianship	724	.79
Power of attorney	629	.69
Name change	464	.51
Birth certificate	175	.19
Other matters	400	.44
Income tax	1,239	1.36
Business	830	.91
Divorce	8,569	9.46
Custody, visitation	2,187	2.41
Support, alimony	4,274	4.72
Adoption	762	.84
Other family	1,735	1.91

UAW–GM LEGAL SERVICES PLAN, UAW LEGAL SERVICES PLAN (CHRYSLER HOURLY EMPLOYEES)—Continued

Cases opened by problem type in 1983	Count	Percent
Criminal	2,215	2.44
Drunk driving	2,101	2.32
Traffic	2,661	2.93
Juvenile	641	.70
Social Security—age	193	.21
Social Security—disability	1,006	1.11
Black lung	20	.02
Medicare, medicaid	92	.10
Unemployment compensation	228	.25
Workers' compensation	311	.34
Other public benefits	231	.25
Pensions	195	.21
Employment agencies	21	.02
Other employment	639	.70
Education	199	.21
Auto property	1,392	1.53
Auto injury	1,160	1.28
Malpractice	476	.52
Assault, battery	300	.33
Conversion	153	.16
Misrepresentation	25	.02
Other tort	2,013	2.22
Immigration, naturalization	82	.09
Auto license	389	.42
Military, selective service	41	.04
Other—Federal	76	.08
Other—State	123	.13
Other—Local	218	.24
Purchase of residence	3,721	4.11
Sale of residence	2,009	2.21
Nonresidential property	1,325	1.46
Landlord-tenant	2,001	2.21
Deeds	1,855	2.04
Foreclosure	974	1.07
Taxes on property	284	.31
Home improvements	255	.28
Other housing	3,076	3.39
Collection action	2,168	2.39
Repossession of client's goods	360	.39
Garnishment	989	1.09
Other debt	1,416	1.56
Possible bankruptcy	2,708	2.99
Credit	813	.89
Consumer complaint	5,294	5.84
Insurance	1,840	2.03
Utilities	404	.44
Other consumer	1,420	1.56
Client as creditor	1,055	1.16
Nonlegal matter	440	.48

Chairman STARK. Thank you.

Do any of you have data with you or available, profiling the users of your plans by salary level? One of the objections that the Treasury makes is that there is some regressivity in how the benefits would accrue to various wage levels. I wondered if any of you have any information on a profile of the salary level of the users.

If you do, we would like to have it submitted and make it part of the record. Go ahead, Mr. Bolger.

Mr. **Bolger**. I think we did have some data of that sort in our study for the Labor Department, although that was not one of the major points that is addresed. I think any quick look at who has legal services will show that the biggest single segment is collectively bargained employees.

Because of the way the section is written, it is very, very hard for very high level employees to get much of a tax benefit out of it. It is not really subject to abuse. You find the plans are most common among unionized wage earners.

Chairman **Stark**. Do you anticipate an increase in the number of plans or the number of beneficiaries under these plans if we extend section 120?

Mr. **Bolger**. Yes.

Chairman **Stark**. Can you quantify that?

Mr. **Bolger**. The projected rate of growth, with or without Section 120?

Chairman **Stark**. Double, or triple? I mean, what do you estimate?

Mr. **Bolger**. We have put out figures, and I think they are attached to my written statement, showing that we have really only reached about 7 percent of the total market. That total market is the underserved 70 percent of the population.

But even if you took, from my point of view, the perfect situation and every working American had a full service comprehensive plan of the sort that we are talking about here today, a negotiated $100 a year plan, in that case which is, you know, highly, highly unlikely, the total revenue loss still would only be in the order of $2 billion.

[The following was subsequently received:]

National Resource Center for
Consumers of Legal Services
3254 Jones Court, N.W. (Wisconsin at Q Street)
Washington, D.C. 20007 (202) 338-0714

APR 17 1984

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Executive Director
William A Bolger

April 13, 1984

The Honorable Pete Stark
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Stark:

On behalf of the members of the National Resource Center and the Coalition to Make Section 120 Permanent, I thank you for conducting hearings yesterday on group legal services plans and for introducing H.R.5361. We appreciate your presence at the hearings yesterday and hope you found the witnesses informative. It was certainly a pleasure to have the opportunity to make our case.

You asked yesterday about statistics on the salaries of plan members. I find that we do not have survey data on that exact point, but the data do show that members of plans are overwhelmingly union members and their families. Less than three percent of the plan members in our Department of Labor survey (see below) were in an employer-funded plan that was not collectively bargained. This indicates that plans are benefitting primarily middle class wage earners rather than higher paid executives or professionals.

Within the union movement plans are well-dispersed among all types of unions. Among blue collar workers the UAW, Laborers' and Teamsters are leaders in providing group legal services plans. The UFCW and AFSCME have many plans for their clerical members, and AFT and NEA locals have bargained successfully on behalf of teachers. Legal services plans are definitely not a limited special-interest benefit. Plans are of least benefit and interest to executives and professionals, who are most likely to have an established relationship with an attorney, who are most competent in conducting their affairs, and who are in least need of assistance.

I enclose the public portion of the draft report we did for the Department of Labor. This portion was made available by DOL at the specific request of Senator Packwood, who placed it in the record of the hearing he conducted in May 1981 on extending section 120. The Center's final report of July 1981 has not been released by DOL, nor have the other three chapters of the draft report been released.

Please contact me if we can be of assistance in any way. I have written Mr. Guarini in response to a number of his questions yesterday. Once again, thank you for your interest in and support of group legal services plans.

Sincerely,

William A. Bolger

William A. Bolger
Executive Director

WAB/sab

enc.

LEGAL PLAN CENSUS:

NUMBER, SIZE, SOURCE OF FUNDING AND DELIVERY SYSTEM

SOURCE: *Draft* report of the National Resource Center to the Department of Labor, dated March 1981. The final report by the Center, dated July 1981, is still under review by DOL and has not been approved or released.

STUDY POPULATION: Plans in existence in June 1979, all of which: 1. were established, maintained or funded by an employment-related group; and 2. involved prepayment of at least $5 per member per year.

The study population was believed to represent 60% of the total universe of plans fitting these criteria. It undercounts insurance company plans and plans established after 1978.

I. NUMBER OF PLANS, BY SOURCE OF FUNDING

FUNDING TYPE	FREQUENCY	PERCENT	SUBJECT TO SECTION 120	SUBJECT TO ERISA
- Employer, Collective Bargaining	36	13.2	19.1%	36.0%
- Employer, Unilateral	16	5.9		
- Union Dues	34	12.5		
- Employee Organization, Gen'l Fund	12	4.4		
- Individual Payment, Voluntary	165	60.7		(64.0%)
- Individual Payment, Mandatory	3	1.1		
- Other	6	2.2		
TOTAL	272	100.0		

II. PEOPLE IN PLANS, BY SOURCE OF FUNDING

FUNDING TYPE	NO. OF PERSONS	% OF PERSONS	SUBJECT TO SECTION 120	SUBJECT TO ERISA
- Employer, Collective Barg.	403,180	57.2	59.7%	95.8%
- Employer, Unilateral	17,310	2.5		
- Employee Assn, Dues	244,879	34.8		
- Employee Assn, Gen'l Fund	8,957	1.3		
- Individual Payment, Voluntary	28,589	3.7		(3.9%)
- Individual Payment, Mandatory	347	0.0		
- Other	1,140	0.2		
TOTAL	704,402*	99.7		

* Taken from 215 plans providing information as to both source of funding and number of persons covered. If weighted for aggregrated plan clusters, total number of persons would be 707,163. The percentages would shift by half of a percent or less.

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III. *MEAN SIZE OF PLANS, BY DELIVERY SYSTEM*

DELIVERY SYSTEM	TOTAL NUMBER OF PERSONS	NUMBER OF PLANS	AVERAGE NO. OF PERSONS	PERCENT OF PERSONS
- Open Panel Plans	16,995	54	314.7	3.8
- Closed Panel Plans	82,797	75	1,104.0	62.4
- Staff Plans	194,330	43	4,519.3	
- Other	149,724	4	37,431.0	33.7
TOTAL	443,846	176	--	99.9

IV. *NUMBER OF PLANS AND NUMBER OF PERSONS COVERED, BY DELIVERY SYSTEM*

DELIVERY SYSTEM	NUMBER OF PLANS	PERCENTS OF PLANS		NUMBER OF PERSONS	PERCENTS OF PERSONS	
- Open Panel	54	Non-Salaried 73.3%	Unrestricted Selection 30.7%	16,995	Non-Salaried 22.5%	Unrestricted Selection 3.8%
- Closed Panel	75		Restricted Selection 67.0%	82,797		Restricted Selection 62.4%
- Staff Panel	43	Salaried 24.4%		194,330	Salaried 43.8%	
- Other	4	Mixed 2.3%	Mixed 2.3%	149,724	Mixed 33.7%	Mixed 33.7%

V. *DELIVERY SYSTEM, BY SOURCE OF FUNDING*

% ROW % COLUMN	OPEN PANELS	CLOSED PANELS	STAFF PLANS	OTHER
- Employer-Funded Plans (Types 1 & 2)	47.2 34.7	25.0 9.9	22.2 19.5	5.6 50.0
- Employee Association (Types 3 & 4)	5.6 2.0	77.8 15.4	16.7 7.3	- -
- Individual Payment (Types 5 & 6)	24.4 63.3	52.8 73.6	21.3 65.9	1.6 50.0
- Other	- -	25.0 1.1	75.0 7.3	- -

LEGAL PLAN CENSUS:

BENEFITS, COVERAGE AND FUNDING LEVELS

SOURCE: *Draft* report of the National Resource Center to the Department of Labor, dated March 1981. The final report by the Center, dated July 1981, is still under review by DOL and has not been approved or released.

STUDY POPULATION: Plans in existence in June 1979, all of which: 1. were established, maintained or funded by an employment-related group; and 2. involved prepayment of at least $5 per member per year.

The study population was believed to represent 60% of the total universe of plans fitting these criteria. It undercounts insurance company plans and plans established after 1978.

I. *BENEFIT STRUCTURE*

BENEFIT STRUCTURE	% OF PLANS	NOTES
Hour Bank - member covered for x hours of service	29.1	90% are closed panel
Schedule of Services - covered matters are listed	14.3	
Shreveport - functional categories used, e.g., office work	31.7	75% are open panel
Advice/Consultation	21.2	80% are staff plans
Other (mostly mixed)	3.7	
	100.0	

II. *MEAN AMOUNT OF CONTRIBUTION, PER MEMBER PER YEAR, BY FUNDING SOURCE*

FUNDING SOURCE	AMOUNT
Employer-funded, collective bargaining	$ 87.00
Employer-funded, unilateral	102.00
Employee association, dues	43.43
Employee association, general revenues	No data available
Individual Payment plans (voluntary)	74.11
Individual Payment plans (mandatory)	No data available
Other	84.00
For all plans:	$ 78.73

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III. *LEGAL MATTERS MOST OFTEN INCLUDED BY PLANS*

LEGAL PROBLEM	% OF PLANS INCLUDING
Advice/consultation	98.6
Court representation	95.7
Office work	94.1
Real estate matters	88.6
Wills	88.6
Consumer matters, including debt problems	88.2
Landlord/tenant	82.9
Family matters	82.6
Misdemeanors	80.9
Divorce	79.7
Governmental/administrative matters, including public benefits	77.3

LEGAL PROBLEM	% OF PLANS INCLUDING
Bankruptcy (personal)	75.4
Traffic matters	75.4
Juvenile matters	72.5
Felony matters - arraignment only	69.4
Probate	69.1
Felony matters - through trial	68.2
Personal injury and/or damage	56.3
Cost/expenses of litigation	52.6
Tax representation	48.5
Tax return filing	11.8

IV. *BENEFIT COVERAGE DIFFERENCES (ONLY) BY SOURCE OF FUNDING*

	Percent of Plans Providing Coverage to Members		
LEGAL PROBLEM	EMPLOYER-FUNDED PLANS	EMPLOYEE (DUES) ASSOCIATION*	INDIVIDUAL PAYMENT PLANS
Family/divorce	76.5	37.5	91.4
Probate	56.3	37.5	88.5
Personal injury	37.5	42.9	64.7
Misdemeanors	68.8	50.0	88.6
Felony - arraignment	56.3	37.5	80.0
Felony - trial	52.9	50.3	71.9
Juvenile matters	58.8	25.0	85.7
Traffic matters	58.8	37.5	91.4
Governmental/administrative	52.9	50.0	93.8
Tax return filing	6.3	25.0	11.4
Tax representation	29.4	25.0	61.8
Costs/expenses	62.5	62.5	54.5

* The small number of cases in this category produces less reliable figures. Cell sizes were too small to yield reliable data for other sources of funding.

V. *PLAN ELIGIBILITY PROVISIONS BY SOURCE OF FUNDING*

FUNDING TYPE	PART-TIME EMPLOYEES	RETIREES	SPOUSES & DEPENDENTS	OFFICERS	OWNERS & SHAREHOLDERS
Employer-funded plans (collective bargain.)	41.2%	35.3%	100.0%	35.3%	23.5%
Employer-funded plans* (unilateral)	25.0%	25.0%	100.0%	100.0%	50.0%
Employee Association (dues)	44.4%	33.3%	66.7%	11.1%	0.0%
Employee Association* (general revenue)	50.0%	33.3%	50.0%	0.0%	16.7%
Individual payment	40.9%	45.5%	59.1%	43.2%	25.0%

* Small number of cases

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Chairman **Stark**. Now, those of the witnesses who are attorneys and speaking for the Bar Association, looking forward to the day when this becomes an entitlement such as medicare and medicaid, for all citizens of the United States, do you all solemnly pledge to take mandatory assignment and subscribe to fee limits as established by the Federal Government to hold the burgeoning cost of this type of program down?

Mr. **Schwartz**. It is quite interesting, Mr. Chairman that I probably am the only person on the panel who is not an attorney——

[Laughter.]

Mr. **Schwartz**. If the ethics of the legal profession would permit me to do so.

Chairman **Stark**. Thank you very much.

Mr. Guarini.

Mr. **Guarini**. That is a very interesting observation, Mr. Chairman.

As I understand it, then, pilots that would be making $100,000 a year or so would be paying the same fee schedule in the plan that other people, such as grocery clerks, who would be making only $10,000 or $15,000 a year; is that right? The fee charges would be the same, the way the plans are situated?

Ms. **Gist**. Yes. The way our plan is designed, for instance, in Minneapolis where we would have airline pilots as well as supermarket clerks—and these are employer paid—the employer would pay a basic premium to cover certain services. We, in turn, would pay the attorneys based on a fee schedule, regardless of who their client is. If their client comes to them through one of the pre-paid plans, we pay "x" amount for a will, "y" amount for a bankruptcy, "z" amount for an adoption.

Mr. **Guarini**. So, both the premiums are the same and the fee schedules are the same; is that correct?

Ms. **Gist**. Assuming that the premium or that the plan was intended to cover the same set of benefits, yes.

Mr. **Guarini**. But it is parallel.

Ms. **Gist**. Yes.

Mr. **Guarini**. Are most of these plans very much similar? Is there much difference in the kinds of numbers that you are dealing with?

I know there are differences in the services that are rendered. But is there a big difference in the charges that are made in the various plans, from airplane pilots on to grocery clerks?

Ms. **Gist**. You mean in the claims paid, in the utilization?

Mr. **Guarini**. Yes.

Ms. **Gist**. Our experience is that in the first year of a plan better educated, more sophisticated consumers like teachers and airline pilots do tend to use the plan more. But as less sophisticated consumers become more aware of the plan through word of mouth when they hear from a coworker that all you have to do is dial this number and you can talk to an attorney and ask a question, and that type of thing, into the second year of the plan, usage picks up considerably and would become comparable to the usage among more sophisticated and better educated plan members.

Mr. **Guarini**. But experience, then, does show in the real world that the people who are better educated are favored by the plan.

Ms. Gist. I do not know what you mean by "favored."

Mr. Guarini. Favored in the sense that they utilize the plan, they know their rights more. They seek redress of their rights.

Ms. Gist. They are perhaps more aware of the benefits that they have through their employer as well. I would not use the word "favored," I would simply say that they have a better understanding at the outset of how they might use a telephone access or telephone consultation service, for instance.

Mr. Bolger. Could I add something?

We have always maintained that the benefits of the preventive law services are the greatest for the people who are probably least educated because they are the people who are most unlikely to effect a satisfactory resolution on their own. They are the ones who most need a champion. That is what the preventive law aspect of all of these plans does.

So, I would say that for the preventive law part which I regard as the most important part—not the insurance aspect of it—the preventive law part benefits disproportionately the less educated or lower income people.

Mr. Guarini. Well, the ones who know their rights maybe are less inclined to get into legal problems. Is that a fact? The ones that take preventive measures are the ones that do not get into the complicated legal problems.

Ms. Gist. That is certainly true.

Mr. Guarini. So, therefore the well-to-do, educated, are always better off in a legal system, no matter how you look at it.

Ms. Gist. And they always have been. That is right.

Mr. Guarini. So therefore, ability to pay is no criteria under our system of plans; right?

Ms. Gist. None at all.

Mr. Guarini. But it is true in the medical profession. It is true in the tax structure. It is true in everything else except on these legal plans. Ability to pay is no longer an important criteria in the advantages that people get.

Mr. Bolger. Yes, that is right.

Mr. Guarini. Now, how do you fare on the insurance. premiums that you charge? Is there more of a profit picture if you are with airplane pilots and, let us say, teachers than you would have with lower wage-scale people?

Ms. Gist. I cannot make that distinction.

Mr. Guarini. Is it a better deal for the insurance company?

Ms. Gist. It depends on what people are using the plan for, obviously.

Mr. Guarini. Well, let us take categories of people because statistically you can come to conclusions. Does the insurance company make more money on better educated people and better paid people than they do on less educated and lower paid people?

Ms. Gist. Generally, our contracts are for 2 or 3 years. Once we are into the second year, utilization of the plan starts to look very similar from group to group in terms of 15 to 20 percent of those eligible for services contacting the plan for services.

Mr. Guarini. The premiums are different though, are they not?

Ms. Gist. Not for the same set of benefits.

Mr. Guarini. They are parallel?

Ms. GIST. Yes, they are.

Mr. GUARINI. So therefore, from your insurance viewpoint, would you rather take an account with better educated people than with less educated people, would it be more profitable for you to handle the people at the top of the scale than the average working people or the less educated people?

Ms. GIST. Not necessarily. If I had to pick a group, I would probably pick a group of young, single women with no dependents, no teenage kids to get into difficulties.

Mr. GUARINI. But you cannot pick the group.

Ms. GIST. Of course not. But you were asking what our preference would be. I cannot make a choice between the higher income folks or the lower income folks because it depends so much on the profile of a particular group.

I can tell you that my ideal group, however, the one in which claims would probably be the lowest, would be something like a group of young, single women.

Mr. GUARINI. But from your experience in a profit picture of every plan that you have in your insurance company, is there a pattern as to which is more profitable than others?

Ms. GIST. Not a pattern.

Mr. GUARINI. All right. Now, with respect to the experience of malpractice, do you find that there are more malpractice claims of people that are in plans than people that are not in plans? Are there statistics available as to the incidents of malpractice?

Ms. GIST. Malpractice claims against attorneys?

Mr. GUARINI. Right.

Ms. GIST. We have no experience whatsoever with malpractice claims against attorneys.

Mr. GUARINI. Does the Bar Association have any concept as to whether or not there is a greater incidence of malpractice and mishandling of clients when they are in a program than when they are in the private sector?

Mr. SCHWARTZ. The American Bar Association has a committee on professional liability that is currently undertaking a study of the causes of malpractice, where it occurs and so forth.

They have not gotten to the point where they created enough data to look at prepaid legal plans since out of the total universe they are such a small portion of the total. But an initial run showed that out of 10,000 or so claims that they had, I think the amount that they had where an attorney was involved in prepaid—this may not have been a claim coming out of a case where the client was in a prepaid plan, but this attorney was somehow on their data sheet involved in prepaid—I think it was like, out of 10,000 claims maybe 20 or 10, or something like that.

Mr. GUARINI. Malpractice is increasing considerably, as you are aware, and attorneys are not at the state that the medical profession is, as far as premiums are concerned.

But I think it might be interesting to take a look at the quality of services that might be given in the legal services paid plans as in the private sector, just as statistically to question, if it need be, the quality of legal services that are performed.

Ms. GIST. Let me make this point, Mr. Guarini: Most of the delivery systems in legal services plans, ranging from the union plans which employ staff attorneys and therefore have a great deal of control over the quality of their work and a great deal of close supervision, to some of our plans where we contract with attorneys—none of the plans that I am familiar with permits a member to go to any attorney and then receive some compensation. There is generally some kind of panel consisting of attorneys who have met some basic criteria, and the attorney's work is monitored to the extent that, No. 1, clients are sent a client satisfaction questionaire in which they are asked about just their basic impressions of the lawyer and the work that the lawyer performed.

Now, obviously, as lay people they will not be able to make a very sophisticated evaluation of the substance of the work, but at least you get some feedback and some red flags can be raised in connection with some problems that there might be with a certain attorney, and then followup is made with that attorney in an effort to look at files and make sure that there is no problem there.

But in any case, client satisfaction questionaires are one vehicle for identifying attorneys who might be a problem, and the second one is actual monitoring of case files where clients sign the claim form and give the administrator permission to take a look at the files.

Most plans that I am aware of have some kind of quality control mechanism built in, so that for instance in a staff plan an attorney who is not performing can be discharged. In a contracting attorney arrangement—like most of our plans—where an attorney is not performing adequately, that attorney no longer receives referrals under the plan.

So, my guess would be that because of the monitoring because of the attempts to take a very close look at the quality of services, malpractice claims would be much less likely among this population than among the broader population.

Mr. SCUPI. If I could comment on that a moment. For the reasons that Ms. Gist has mentioned, in our experience there is no malpractice. We are now, in the programs that UAW has negotiated, handling over 100,000 cases a year, and for 5 years we have been carrying the usual sort of malpractice insurance, and there has never been a claim submitted to our carrier yet.

Mr. GUARINI. Well, I am surprised and I accept that as a fact, and I commend the attorneys that you use.

I was just wondering, if an error is made and a lawyer does not perform properly, does the insurance company that insures the plan stand behind the attorney for the malpractice so that the client is protected?

Ms. GIST. No; our contract with the attorneys specifically states that we have no liability. However, we will not contract with an attorney who does not carry a certain level of malpractice insurance. That is a very basic criterion employed by all plans, so that the insurance is there but it has just never come up.

Mr. GUARINI. There would be no conflict of interest your being in the insurance business, if you had confidence in the attorneys that you choose, why not stand behind and make good if the attorneys do not perform properly?

Ms. GIST. Come now, we are business people and that is simply a risk that we do not undertake.

Mr. GUARINI. It undermines the confidence in the quality of lawyers that you——

Ms. GIST. That hardly communicates a lack of confidence, I do not think. It is just good business.

Mr. SCUPI. In our arrangements it is a little different because most of our cases are handled by staff attorneys. So, that means the trust itself is the employer and would be liable for malpractice. So, in that sense the program stands behind the attorneys because it itself would be liable.

In the other types of cases where we refer cases to attorneys in private practice, we too require that they have malpractice insurance. But in our programs it is a little different because even in those cases we make ourselves voluntarily equally liable with the attorney.

Mr. GUARINI. Do the clients or members of the union or group ever sue the plan? The plan is incorporated, is it not?

Mr. SCUPI. No; but it can be sued.

Mr. GUARINI. It could be sued. Are there any law suits where the clients because of misplaced trust, or incompetency, or for various reasons feel that they were not properly served?

Mr. SCUPI. If there were any, they would be referred to our malpractice carrier and, as I stated earlier, there has never been a claim referred to our malpractice carrier.

Mr. GUARINI [presiding]. Thank you very much.

[The following was subsequently received:]

NATIONAL RESOURCE CENTER FOR
CONSUMERS OF LEGAL SERVICES,
Washington, DC, April 13, 1984.

Re: H.R. 5361, H.R. 5028; group legal services plans.

Hon. FRANK J. GUARINI,
U.S. House of Representatives, Washington, DC.

DEAR MR. GUARINI: On behalf of the members of the National Resource Center and the Coalition to Make Section 120 Permanent, I thank you for attending the hearings yesterday on group legal services plans. We appreciate your interest and your questions, and hope you found the witnesses informative. It was certainly a pleasure to have the opportunity to make our case.

You asked yesterday about open versus closed panels, quality control and utilization of plans by type of group. I'm enclosing information on all three areas. The open versus closed panel debate has ended and common sense has prevailed. Each type of delivery system works best in some situations. Many plans use a combination of methods. The most common arrangement is for the plan to select a panel on a competitive basis from among interested firms, but just about any variation you can imagine is being used somewhere.

Overall utilization of plans does not vary too much by income. The most important variable is the design of the plan. Some plans encourage preventive law more than others. The age and family situation of the plan's members can affect utilization of specific benefits very greatly, but overall utilization is quite predictable. Almost all plans provide for equal contributions on behalf of each employee and equal benefits. There is one contribution rate, and one set of available benefits.

Quality control is a primary concern of most plans. I am pleased to enclose some survey data from plan clients that gives the plans and attorneys very high marks. I know of no data (or even charges) suggesting that legal plan members receive inferior quality service compared to non-plan members.

Please contact me if we can be of assistance in any way. Once again, thank you for your interest in and support of group legal services plans.

Sincerely,

WILLIAM A. BOLGER,
Executive Director.

Enclosure.

PREPAID LEGAL SERVICE PLANS IN THE EMPLOYMENT CONTEXT

DOL Draft Report
March 1981

THE NATIONAL RESOURCE CENTER FOR CONSUMERS
OF LEGAL SERVICES
3254 Jones Court N.W.
Washington D.C. 20007

STUDY OF LEGAL PLANS
PREPARED FOR THE
DEPARTMENT OF LABOR

Draft Report
March 1981

I. Introduction
II. *A Profile of Operating Legal Service Plans*

NOTE: This is only a portion of the draft report. It is available because it was placed, at the specific request of Senator Robert Packwood (R, Ore.), on the record of the public hearing on May 22, 1981 on S.1039, a bill to improve and make permanent section 120 of the Internal Revenue Code. The final 3 chapters of the draft report are not included.

The Center's final report, July 1981, to the Department of Labor is still under review at DOL and has not been released. It contains substantial revisions from the draft report but is based on the same data.

DRAFT

PREPAID LEGAL SERVICE PLANS IN THE EMPLOYMENT CONTEXT:

A Report of Major Characteristics and Tax and Regulatory Issues

Submitted to:

The Department of Labor
Labor Management Services Administration
Pension and Welfare Benefits Programs

March 1981

National Resource Center for
Consumers of Legal Services

DRAFT

Chapter One: Introduction

1.1 Purpose and Scope of the Study

Legal service plans are a new type of benefit provided in the context of employment as well as to members of non-employment groups such as consumer cooperatives and student organizations. They provide personal legal services, or reimbursement for such services, to employees or members of groups.

In the space of a few years, prepaid legal services have become an increasingly popular employee fringe benefit. A wide variety of unions in every sector of the economy have expressed an interest in prepaid legal services. Pioneered in the construction industry by the Laborers' International Union and rapidly followed by plans for municipal employers, legal service plans of every size and description have been established in every part of the country.

An apparent impetus to this development was the passage of the Tax Reform Act of 1976 which provided employer-funded plans with favorable income tax treatment. The Tax Reform Act of 1976 added section 120 to the Internal Revenue Code, granting an exclusion from employee gross income for both amounts contributed to legal service funds by an employer on behalf of his employees, as well as the value of legal services benefits received by employees.

Other significant federal legislation which impacts legal service plans is the Employee Retirement Income Security Act of 1974 (ERISA). Prepaid legal plans which are subject to ERISA were made subject to its reporting and disclosure provisions and to fiduciary standards.

By the Tax Reform Act of 1976, both the Secretaries of the Treasury and Labor are required to conduct by 1980 for the President and the Congress "a complete study and investigation with respect to the desirability and feasibility of continuing the exclusion from income of certain prepaid groups legal services benefits...."

This study of prepaid legal service plans had been conducted under contract to the Department of Labor during the period 1978-1980. It provides the first statistically reliable profile of plans that are subject to either the Employee Retirement Income Security Act (ERISA) or to Section 120 of the Internal Revenue Code.

This study has been conducted in order to achieve two principal objectives. The first is to provide a basis for determining whether the mandates of the Employee Retirement Income Security Act are being fulfilled with respect to legal service plans, particularly whether the present provisions of the Act and its administration are adequate to ensure the healthy development and operation of the plans and their compliance with disclosure, fiduciary and other standards of the Act. The second objective is to provide a portion of the data base necessary for the study and investigation mandated by Congress in connection with Section 120 of the Internal Revenue Code.

Accordingly, while the universe of legal service plans includes many types of plans, the study population has been defined to cover principally those plans subject to the Employee Retirement Income Security Act, and those plans funded by employers and therefore subject to recognition under Section 120. Additionally, the study population includes those bona fide group prepaid legal service plans, presently funded by individual contributions, which appeared to offer the potential for conversion to the status of a plan subject to ERISA or to Section 120.

The methodology involved in the construction of the study population is described in detail in Appendix A. Briefly, The study population was defined to include plans having all of the following characteristics:

--the plan is established, maintained or funded by a group, such that the group sponsors, collects funds, administers, or performs some function in connection with the plan;

--the group associated with the plan is employment-related, consisting of either an employer, an employee association, or some other employment-related organization;

--the plan involves prepayment of services.

A list was compiled of those plans in existence as of June, 1979 which clearly met or might potentially meet the profile of plans relevant to the study. Non-conforming plans were excluded from the list. Table 1.1 illustrates the decision track involved in the selection of plans in the study population. The first filter, group identification, is not shown.

A list of approximately 2700 plans potentially subject to the study was complied from a variety of sources, including the records of the U.S. Department of Labor, the files of the National Resource Center for Consumers of Legal Services, and filings made with agencies of state government. This list of 2700 is by definition a subset of the total universe of all legal service plans, since no effort was made to include those group advice and referral plans, consumer plans, and other non-employment groups that could readily be identified as such. Additionally, of course, no claim is made that the search process identified every single plan potentially subject to the study. (See Appendix A for details.)

After cleaning for duplicate plans, plans no longer in existence, plans declining to participate in the study, and those for whom telephone numbers could not be obtained, a telephone screen was administered to a list of approximately 1600 plans. Of the 1328 completed telephone surveys (an 82% response), 266 plans were identified as qualifying for the study population. The majority of those not qualified are believed to be non-prepaid plans, the so-called group advice and referral plans. The group of 266 prepaid plans constitutes the study population.

The study population is characterized by a substantial number of "clustered plans". These are groups of similar plans marketed and administered by a single organization, provided through a number of separate, employment-related groups. Mail questionnaires for these groups often were sent to the central administrator for response. (More detail is provided in Appendix A.) In order to minimize respondent burden, administrators for the larger clusters were permitted to return a single mail questionnaire containing aggregated responses. (Individual plan data covering source of funding, size, retiree and spousal eligibility were obtained for each plan in the study population through the telephone survey.) Table 1.2 describes the configuration of respondent plans. Data for the study is drawn from both the telephone questionnaire (266 cases) and the mail questionnaire (covering 191 cases).

TABLE 1.2 DISTRIBUTION OF SINGLE AND CLUSTERED RESPONDENTS

←191 Cases Covered by Mail Questionnaires→

←85 Mail Questionnaires→

45	40	106	75
Single Mail Respondents	Clustered Mail Respondents	Clustered Teleph. Respondents	Single Teleph. Respondents

← Study Population: 266 cases →

Difficulties were encountered at each step in the survey as a consequence of the extraordinary variety among plans and the absence of a uniform terminology to characterize their differences, and some reluctance on the part of respondents to report on their plans. In addition, plans experienced difficulty in categorizing their structures; interviewers experienced difficulty evaluating answers given them and coders experienced similar difficulties. After survey data had been gathered, coded and data entered by the research subcontractor, examination of the directory by legal service plan experts revealed the omission of certain large, well-known plans. Consequently, for certain tabulations and cross-tabulations of key variables, data values for eight "found" plans were added to the data gathered from the study population and manually recalculated.

1.2 Research Objectives

The study of prepaid legal service plans has yielded two concrete products. The first is a directory tape of all plans in the United States which have been identified as meeting the study profile. The directory contains a list of the names and addresses of all currently operating plans provided in the context of the employment relationship. It is organized by state and also contains information on the number of persons covered by each plan.

The study's major product is this descriptive report based on a statistically reliable survey of plans. It profiles the major characteristics of plans and analyzes both the federal income tax consequences and the regulatory issues associated with their continued growth.

The profile will describe plans in terms of the following characteristics:

Size
Source of Funding or Sponsorship
Legal Service Benefits
Delivery System
Eligibility Requirements
Plan Costs
Utilization of Benefits
Grievance Systems

More specifically, the study attempts to address some of the following broad questions:

Regulatory Analysis

1. How many legal service plans are presently subject to ERISA, what are their characteristics, and how many persons are covered by these plans?
    a) Are there operational or structural characteristics of prepaid legal plans that would warrent reevaluation of the regulatory requirements of ERISA as they presently apply to such plans?

   b) What benefits patterns characterize prepaid legal plans? Which employees are covered? Is coverage provided to spouses and dependents, retirees or other classes of persons?
   c) Are there substantial cost differences associated with different delivery systems.

2. What is the proportion of plans established by employee associations as compared with plans established by employers (unilaterally or through collective bargaining)? Are there differences between employer and employee funded plans that have consequences for regulation?
3. Do plans subject to ERISA have claim and grievance systems as the Act requires? Are the present filing and reporting requirements of ERISA adequate and do they seem to be complied with?

Tax Analysis

1. How many employer-funded prepaid legal service plans are there and what is the date of establishment of each plan?
2. How many employees are covered by employer-funded prepaid legal service plans?
   a) What proportion of plans extend services of spouses and dependents of employees?
   b) What proportion of plans extend services to retired employees?
   c) What proportion of plans extend services to officers, directors or shareholders?
3. What is the average cost per person (contribution) of the employer-funded plans?
4. What services are routinely provided under such plans?

1.3 A Definition of Major Plan Variables

The most important variable of stratification for the study is source of funding since categorization by funding type more clearly defines plans in the study which are subject to ERISA or to Section 120. But, as indicated earlier, there is a continuum of funding possibilities and it is not always easy to classify the different funding sources. For example, a credit union may receive an annual lump sum contribution from an employer to defray costs of maintaining an individual enrollment legal service plan for credit union members. A plan that has employer funding may also have employee contributions. (This seems relatively rare in legal services, since the total amount of money involved in an annual legal services "premium" or contribution is relatively small.)

The basic funding types are described below:

TYPES	DEFINITIONS
Employer-funded through collective bargaining	Full or partial funding of the plan by the employer or group of employers as the result of a collective bargaining agreement.
Unilaterally employer-funded	Full or partial funding of the plan is provided by the employer or a group of employers as an unbargained fringe benefit of employment.
Union or employee association dues-funded	Funding of the legal service plan by a union or employee association from membership dues.
General union or employee association funded	Funding of the legal services plan by the union or employee association from any source, except membership dues.
Individual employee-funded	Funding or partial funding of their enrollment in the plan by individual employees.

The principal distinction between the dues funded plans and those funded out of general revenues is the use in dues plans of a per capita, earmarked payment assessed equally against all members or employees of the group. In the individual payment plans, the individual must decide to enroll in order to participate, but he need not do so.

All of the funding mechanisms are group funding mechanisms. The first four could be characterized as "true group" plans, where every member is automatically covered by the plan. Funding is either from a third party (such as the employer or the union) or from payments made automatically by all members (dues). The individual payment plans could be called "assocation group" plans, and are primarily distinguished by the voluntary character of enrollment and payment.

Two other stratification variables of less importance require some explanation. One is benefit structure. There have been a number of approaches taken on the structuring of legal services benefits. Generally, the different structure in legal services reflect the same issues that the health care sector has debated in recent years. These include the effect on cost and quality control of the use of schedules of services and copayments; direct service versus indemnity benefits; and other similar issues. In legal services, limitations on attorney time are an additional technique of control.

With the expectation that legal service plans will one day be widely in operation, the use of benefit structures as one of the variables of stratification may provide baseline data useful in future studies of inflation or distortion in legal services costs or service utilization. Such studies, now being conducted in the health care sector, will likely shape the development of public policy toward legal service plans and may directly affect the direction of plan development.

Below is a description of the benefit structures commonly in use in the legal services field:

TYPES	DEFINITIONS
Hour Bank	The plan provides a certain number of cases or hours of attorney time per year which may be used on any legal service or specified types of legal services.
Fee Schedule	The plan provides a list of specific legal services (fees schedules), each of which may be covered fully or partially.
Shreveport Plan	The plan divides covered benefits into several major service activity categories (such as advice and consultation, office work, court representation) and provides coverage for each of these service categories fully or with dollar or hourly limitations.
Group Advice/Referral	The plan provides mainly group and consultation with other legal services provided at reduced fees.

The first structure, the hour bank, is unique to the legal services field, and has its closest analogy in the relative value schedules in use in the medical sector. The second benefit structure, the fee schedule, is commonly in use in the benefits field. The third, named after the first legal service plan to be established, has also been widely imitated. The fourth category represents a version of the group advice and referral plan, but one which requires a substantial prepayment and provides a sufficient level of benefits to justify its being classed as a prepaid plan.

Finally, the issue of delivery system requires some discussion. Respondent plans were asked which of the following delivery systems described their plan:

Open Panel - Services are provided either (1) by any attorney chosen by the plan member, or (2) by an attorney(s) who participates on a panel sponsored by a bar association, or (3) by an attorney(s) who agrees to participate on a panel open to any attorney.

Closed Panel - Services are provided by individual attorneys, a law firm, or several law firms which are selected by the plan.

Staff Panel - Services are provided by an attorney or staff attorneys who are hired by the plan.

These categories necessarily contain some arbitrariness since plan delivery systems describe a continuum rather than falling inevitably into discrete clusters. A closed panel plan in which the number of firms is large begins to resemble the open panel plan which does not have widespread participation by the bar. Still, respondents seemed to have no difficulty in characterizing their plans in one of the three primary delivery system categories.

In the profile of plans which follows in Chapter Two plans are characterized by these three main variables which demarcate the areas of funding, benefits, and service delivery.

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Chapter Two: A Profile of Operating Legal Service Plans

This chapter provides a profile of the legal service plans in existence as of June, 1979. The sections following describe various aspects of the structure and operation of plans. In this description the statistical measures which are primarily used are those of central tendency and frequency of distribution. The profile analyzes the following basic descriptors:

- Number and Distribution of Plans
- Size of Plan
- Delivery System
- Benefit Structure
- Types of Benefits
- Eligibility for Plan Coverage
- Age and Utilization Experience of Plans
- Plan Costs

2.1 Number and Distribution of Plans

The study population consists of 266 plans carefully screened to ensure that subject plans met the study's operational definition of a plan. The study population is known to be a subset of the universe of plans. However, there are also two known sources of undercounting in the number of plans in the study population. One is that insurance plans are underrepresented (see Appendix A, Research Methodology, for more detail). Between 75-90 additional plans would be subject to the study had the principal insurer participated in the study and these insurance plans had been included.

A second source of undercounting (which is also reported in Appendix A) was the inability of interviewers to secure telephone numbers for 21.5% of the potential eligible plans in the master plan list. These plans were therefore dropped from the study. However, if telephone numbers had been secured, and if the screening calls yielded plans eligible for the survey in the same proportion as those which *were* found to be eligible, it is estimated that an additional 89 plans might have been found. Nevertheless, while there is no basis for believeing that the inaccessible plans differed in any substantial respect from the accessible plans, such a calculation remains speculative.

Considering the missing insurance plans (probably at least 75 cases) and the plans not reached by telephone (estimated at 89 cases), the study population of 266 plans could be expanded as follows:

266	Confirmed plans in study population
8	Plans omitted in error - referred to as "found" plans
75	Insurance plans
89	Plans for which telephone numbers could not be found
438	Estimated plans in universe

If these estimates of plans in the universe which fit the operational definition of plan are reliable, the population would consist of slightly more than 60% of the estimated number if existing plans.

Table 2.1 describes the geographic distribution of the 266 plans (plus the 8 "found" plans) and the number of persons reported covered in each state. (The number of persons reported covered in each state represents *only* those plans which provided data on number of persons covered.) The plans are found in every region of the country, with a predictable concentration in the large industrial states. Three states - California, New York and Michigan - contain 75.9% of the total number of persons reported to be covered. Four additional states - Alaska, New Jersey, Ohio and Pennsylvania - account for 93.3% of the total number of covered persons.

TABLE 2.1 LEGAL SERVICE PLANS: DISTRIBUTION BY STATE

State	No. of Plans	Plans Providing Membership Figures	Number of Members	Percent of Total
Alabama	7	6	65	0.009
Alaska	2	2	24,400	3.467
Arizona	2	1	1,140	0.162
California	80	46	202,450	28.768
Colorado	1	1	724	0.103
Connecticut	1	1	3,000	0.426
District of Columbia	3	3	11,090	1.575
Florida	15	12	1,803	0.256
Hawaii	23	17	4,704	0.668
Illinois	7	6	3,879	0.551
Iowa	1	1	220	0.031
Kansas	5	4	345	0.049
Louisiana	1	1	600	0.085
Maine	2	1	1,300	0.181
Maryland	26	23	4,143	0.589
Massachusetts	1	1	5,000	0.710
Michigan	5	5	144,807	20.577
Nebraska	1	1	10	0.001
New Jersey	3	3	24,700	3.510
New York	10	10	187,250	26.608
North Carolina	17	15	1,055	0.150
Ohio	15	11	31,191	4.432
Oklahoma	3	3	165	0.023
Oregon	12	12	400	0.057
Pennsylvania	5	5	41,815	5.942
Rhode Island	1	1	3,000	0.426
Texas	8	8	395	0.056
Utah	13	12	2,016	0.286
Virginia	3	2	630	0.089
Wisconsin	1	1	1,112	0.158
TOTAL	274	215	703,409	99.945

From this data the mean size of a prepaid legal service plan in the study was found to be 3,271.6 members.

TABLE 2.2 NUMBER OF PLANS BY SOURCE OF FUNDING

Funding Type	Frequency	Percent	Subject to Section 120	Subject to ERISA
1. Employer, Collective Bar.	36	13.2	19.1%	36.0%
2. Employer, Unilateral	16	5.9		
3. Union Dues	34	12.5	16.9%	
4. Employee Organization, general funds	12	4.4		
5. Individual Payment, Voluntary	165	60.7		64.0%
6. Individual Payment, Mandatory	3	1.1		
7. Other	6	2.2		
TOTAL	272	100.0		

Table 2.2 depicts the distribution of plans over the 7 categories of funding source or sponsorship which were defined in Chapter 1. As shown in the table a high proportion of plans in the study are funded by individual payments, as compared to plans funded through employer or employee organization sources. Table 2.2 indicates that only 19.1% of the plans in the study population (plus the "found" plans) are funded by employers and thus subject to recognition as qualified group legal service plans under Section 120 of the Internal Revenue Code. 36% of the plans in the study are subject to the Employee Retirement Income Security Act. This figure, however, should be considered with caution since it is subject to two sources of variation. First the study did not inquire whether the employer groups were private or public entities. The group of employer plans in the study population is known to include several government plans, which are not subject to ERISA. Second, some of the individual payment plans may be minimally or informally sponsored by employee associations, and, depending on the facts and

circumstances of each case, might be considered a plan "established and maintained...by an employee organization."

Since funding through an insurance company may substantially change the character of a plan, the study examined the proportion of plans in the study population that were fully or partially insured. Recognizing that insured plans were substantially underrepresented in the study population, there still were 18.2% fully insured plans contained in the population.

TABLE 2.3 PLANS FULLY OR PARTIALLY INSURED

	Fully Insured	Partially Insured	Not Insured	Total
Frequency	30	3	132	165
Percent	18.2	1.8	80.0	100.0

2.2 Size of Plans

While the average plan size nationwide was found to be 3,271.6, average plan sizes vary widely when controlling for different funding sources. Table 2.4 provides a breakdown of mean plan sizes by source of funding. Evident from the table are the extreme ranges in size of plans, even within certain funding source categories. Table 2.4 attempts to correct for extremes, providing mean sizes that are only slightly positively skewed if at all. The corrected mean for all plans provided in Table 2.4 excludes 3 cases with large plan sizes. If all individual payment plans were excluded, the corrected mean for plans in funding categories 1-4, ERISA plans, would be 2,915.7.

TABLE 2.4 MEAN SIZE OF PLANS BY SOURCE OF FUNDING

Funding Source	Number of Persons*	No. of Plans	Arithmetic Mean	Corrected Mean
1. Employer Funded, Collective Bargaining	403,180	33	12,187.3	4,651.0
2. Employer Funded, Unilateral	17,310	14	1,236.4	50.8
3. Employee Association, Dues	244,879	33	7,420.6	2,965.0
4. Employee Association, General Funds	8,957	11	814.3	814.3
5. Individual Payment, Voluntary	28,589	117	244.4	203.4
6. Individual Payment, Mandatory	347	3	115.7	115.7
7. Other Source	1,140	4	285.0	9.3
TOTAL	704,402	215	3,271.6	1,393.4

*In all cases, "number of persons" refers to the number of primary covered persons, and does not include spouses or dependents unless specifically so indicated.

A comparison of the number and sizes of plans, as contained in Table 2.5 below, provides a more accurate picture of the plans by source of funding. Fully 95.8% of the persons covered by a legal service

TABLE 2.5 NUMBER AND SIZE OF PLANS, BY SOURCE OF FUNDING

Funding Source	No. of Plans	% of Plans	No. of Persons	% of Persons	Subject to §120	Subjec to ERI
1. Employer Funded, Collect. Bargaining	36	13.2	403,180	57.2	59.7%	95.8%
2. Employer Funded, Unilat.	16	5.9	17,310	2.5		
3. Employee Assoc., Dues	34	12.5	244,879	34.8		
4. Employee Assoc., Gen.Funds	12	4.4	8,957	1.3		
5. Individual Payment, Volun.	165	60.7	28,589	3.7		3.9%
6. Individual Payment, Mand.	3	1.1	347	0.0		
7. Other	6	2.2	1,140	0.2		
TOTAL	272	100.0	704,402*	99.7		

*Taken from 215 plans providing information as to both source of funding and number of persons covered. If weighted for aggregated plan clusters, total number of persons would be 707,163. The percentages would shift by half of a percent or less.

plan are members of plans subject to ERISA. Nearly 60% are members of plans subject to recognition as qualified group legal service plans under Section 120. Only 4.2% of the persons covered by legal service plans of the type described by this study are not subject to any sort of federal regulation.

TABLE 2.6 NUMBER AND PERCENT OF PLANS BY SIZE CATEGORY AND DATE OF ESTABLISHMENT*

Date Estab.	1-499	500-999	1000-2499	2500-4999	5000 or more	TOTAL
1973	3 42.9	1 14.3	2 28.6	0 0.0	1 14.3	7
1974	4 33.3	1 8.3	2 16.7	1 8.3	4 33.3	12
1975	15 65.2	3 13.0	2 8.7	0 0.0	3 13.0	23
1976	13 61.9	3 14.3	3 14.3	0 0.0	2 9.5	21
1977	26 72.2	2 5.6	3 8.3	1 2.7	4 11.1	36
1978	44 81.5	1 1.9	2 3.7	3 5.6	4 7.4	54
TOTALS	105 68.6	11 7.2	14 9.2	5 3.3	18 11.8	153

*Table excludes 1979 and 1980 plans, since survey undercounts plans established after 1978; the master plan list was compiled during the summer of 1979.

Because of the large number of very small plans, plans with fewer than 500 members comprise 63.9% of the plans. Plans with more than 5,000 members comprise 13.5%. Table 2.6 shows that while the number of large plans is increasing steadily, smaller plans form an increasingly larger proportion of the plans being established. This is explained in part by the fact that the individual payment plans, which tend to have a smaller mean size than plans established by the employer, the union or both, are being vigorously marketed commercially.

The size of plans also appears to be a function of the type of delivery system which is used. Plans characterized themselves as delivering services on either an open panel, closed panel or staff basis. (See Chapter One for detailed definitions.) Plans were also permitted to characterize their delivery systems as "other". It was found that this category was used by one of the larger plans whose delivery system was "mixed", that is, providing services through a variety of delivery mechanisms, depending on the concentration of members to be served.

Table 2.7 describes the number and mean size of plans by delivery system. (It is weighted for plan clusters and contains the "found" plans.) The Table reveals very large differences in average number of persons covered or plan size in open and closed panel and staff plans. As noted above, the one large plan which provides services utilizing a mixture of open, closed and staff delivery mechanisms, is included in the "other" category. If current trends continue and plans which provide services on a national basis continue to adopt the open panel delivery, there is a strong liklihood that the mean size of open panels will increase. This will especially be the case if the concentration of covered plan members is insufficient to support the establishment of closed panel or a staff delivery system.

The following section examines delivery systems in greater detail.

TABLE 2.7 MEAN SIZE OF PLANS BY DELIVERY SYSTEM

Delivery System	Total Number of Persons	Number of Plans	Average No. of Persons	Percent of Persons
Open Panel Plans	16,995	54	314.7	3.8%
Closed Panel Plans	82,797	75	1,104.0	62.4%
Staff Plans	194,330	43	4,519.3	
Other	149,724	4	37,431.	33.7%
TOTAL	443,846	176		99.9%

2.3 Delivery System

As the previous section demonstrated, the plans tend, by more than two to one, to deliver services on either a closed panel (private law firm) or a staff basis. Two issues have been debated involving delivery systems. One is the degree of choice provided to the client-participant in the selection of an attorney. This issue involves ethical concerns, and also affects the degree of which the private bar generally is able to participate in prepaid legal work. The second issue, also involving both ethical and economic issues, is whether plans should be structured so as to provide services primarily through salaried sttorneys or through the private bar. Section 302(c)8 of the Taft-Hartley Act (Labor Management Relations Act of 1949) expressly leaves the issue of delivery system structure to the parties in collective bargaining, to select "counsel or plan of their choice".

Open panel delivery systems by definition involve the private bar. Closed panel delivery systems generally involve small numbers of private law firms. While the study did not inquire about the method of compensation of attorneys, it can be assumed that closed panel law firms were not generally compensated on a salaried basis. Table 2.8 reviews the distribution of plans among the three basic types of delivery system, examining the percent of plans and the percent of persons covered, in the context of the two delivery system issues.

TABLE 2.8 NUMBER OF PLANS AND NUMBER OF PERSONS COVERED BY DELIVERY SYSTEM

Delivery System	Number of Plans	Percents of Plans		Number of Persons	Percents of Persons	
Open Panel	54	Non-Salaried 73.3%	Unrestricted Selection 30.7%	16,995	Non-salaried 22.5%	Unrestricted Selection 3.
Closed Panel	75		Restricted Selection 67.0%	82,797		Restricted Selection 62.4%
Staff Panel	43	Salaried 24.4%		194,330	Salaried 43.8%	
Other	4	Mixed 2.3%	Mixed 2.3%	149,724	Mixed 33.7%	Mixed 33.7%

Table 2.9 compares the percent distribution of the three delivery systems by funding source. An examination of it reveals a somewhat mixed use of these systems. Employer-funded plans are equally divided between open panels and either closed panels or staff plans. That is, nearly one-half of the employer plans provided an unrestricted selection of attorneys. Employee association plans, regardless of whether funded by dues or from general association revenues, tended overwhelmingly to favor either closed panels or staff plans. Individual payment plans also tended to favor closed panel or staff plans over open panels by a three to one margin.

TABLE 2.9 DELIVERY SYSTEM BY SOURCE OF FUNDING (Reported by Percents)

% Row % Column	Open Panels	Closed Panels	Staff Plans	Other
Employer-Funded Plans (Types 1 & 2)	47.2 34.7	25.0 9.9	22.2 19.5	5.6 50.0
Employee Association (Types 3 & 4)	5.6 2.0	77.8 15.4	16.7 7.3	-- --
Individual Payment (Types 5 & 6)	24.4 63.3	52.8 73.6	21.3 65.9	1.6 50.0
Other (Code 7)	-- --	25.0 1.1	75.0 7.3	-- --

The difference in the mean number of attorneys associated with open and closed panels is predictably large. Open panels involve an average of 687 attorneys; closed panels (law firms) involve an average of 28 attorneys. Comparable figures are not available for staff plans. The open panel figure is marginally useful as a national average; however, it is extremely sensitive to state size, since bar-sponsored plans attempt to secure broad attorney participation on their state panels. Because attorney population per state differs in direct proportion to the size (population) of the state, this figure in the future could represent little more than the proportion of attorneys participating nationally on an open panel, expressed as a per state average.

2.4 Benefit Structure

Chapter One describes the three kinds of benefit structures currently in use in prepaid legal service plans. Briefly, they include the Hour Bank (client-participant is entitled to "x number of hours" of service), the Schedule of Services (listing each covered legal matter in a schedule), and the Shreveport Plan (division of benefits into functional categories: advice; office work; and representation with coverage provided fully or partially.)

A fourth category, Advice/Consultation, represents a type of group advice and referral plan which provides unlimited telephone advice and consultation, plus other services.

The plans in the study population were relatively evenly spread over the four categories:

Hour Bank	29.1%
Schedule of Services	14.3%
Shreveport Plan	31.7%
Advice/Consultation	21.2%
Other	3.7%

The different benefit structures appear to correlate fairly strongly with particular delivery systems. For example, nearly 90% of the Hour Bank plans are closed panels. Similarly, 75% of the Shreveport Plans are provided on an open panel basis, and nearly 80% of the Advice/Consultation plans are provided by staffs of attorneys. The Schedule of Services appears across all delivery systems, but it is found in conjunction with closed panels twice as often as with either open panel or staff plans.

Because of small cell sizes and statistically unreliable data values, no useful information is available on the mean number of hours of service provided by the Hour Bank plans. However, most plans appear to provide between 20 to 100 hours of service per person, maximum.

The various benefit strctures do not correlate particularly strongly with source of funding. Plans funded by employers through collective bargaining are fairly evenly spread among the Hour Bank, Schedule of Services and Shreveport Plans. Employers funding plans unilaterally appear to prefer the Shreveport Plan. However, this preference is based upon a rather small number of cases. Employee association plans, both those funded from dues and those funded from general revenues, appear evenly spread across all three benefit structures, plus telephone advice and consultation. Individual payment plans utilize all four benefit structures (including telephone advice and consultation) in fairly even proportions.

2.5 Types of Benefits

In the maii survey an effort was made to determine what types of legal matters are typically covered by legal service plans. Tables 2.10 and 2.11 provide,in descending order, lists of legal matters most often covered and most often excluded. The first three categories (advice, office work and court representation) are functional descriptions which accomodate the plans having a Shreveport plan type benefit structure.

From the table several aspects of plan coverage are particularly noteworthy:

a) Misdemeanor and juvenile criminal coverage are more likely to be provided then felony coverage;

b) Some plans provide felony criminal coverage only in the "emergency" stages of the felony matter - through arraignment only;

c) Probate and personal injury coverage, both traditionally provided on a contingent fee basis, are covered in some way by a large proportion of the plans (69.1% and 56.3% respectively);

d) Approximately one-half of the plans provide some coverage for the non-fee costs associated with legal services;

e) Approximately half of the plans provide representation in tax court but few provide tax preparation services;

f) A substantial proportion of plan coverage involve legal matters where the government is a party or is being petitioned to grant some privilege or status.

There appear to be some significant differences in the contents of benefits packages between plans with different funding sources. Information was always obtained from respondents on those legal matters which were neither specifically included nor excluded from the benefits packages. Among responses from individual payment plans, this third category contained very consistently low or zero values, suggesting that individual payment plans are far more detailed in explaining what matters are and are not covered. Since there is higher adverse selection associated with individual payment plans, it is reasonable to expect greater care to be taken in defining the coverage available under these plans. Another factor is that Hour Bank plans, which by definition do not specify the legal matters on which the client's hours may be spent, include only a small proportion of individual payment plans. There are other significant differences in the contents of benefits packages between plans with different funding sources - as reported in Table 2.12. For instance, with one exception, individual payment plans provide, on the average, either the same or broader coverage than either employer-funded plans or dues-funded plans. ("Broader coverage" means the inclusion of more legal matters, but does not necessarily mean that the depth of coverage is better. That is, a plan may cover more legal matters, but provide less actual dollar coverage for particular matters or overall.)

TABLE 2.10 LEGAL MATTERS MOST OFTEN INCLUDED BY PLANS

Legal Problem	% of Plans Including
Advice/consultation	98.6
Court representation	95.7
Office work	94.1
Real estate matters	88.6
Wills	88.6
Consumer matters, including debt problems	88.2
Landlord/tenant	82.9
Family matters	82.6
Misdemeanors	80.9
Divorce	79.7
Governmental or administrative matters, including public benefits	77.3
Bankruptcy(personal)	75.4
Traffic matters	75.4
Juvenile matters	72.5
Felony matters - arraignment only	69.4
Probate	69.1
Felony matters - through trial	68.2
Personal injury and/or damage	56.3
Cost/expenses of litigation	52.6
Tax representation	48.5
Tax return filing	11.8

TABLE 2.11 LEGAL MATTERS MOST OFTEN EXCLUDED BY PLANS

Legal Problem	% of Plans Excluding
Tax return filing	70.6
Costs/expenses of litigation	36.4
Tax representation	30.9
Felony matters - through trial	19.7
Felony matters - arraignment only	19.4
Personal injury and/or damage	18.8
Probate	17.6
Juvenile matters	17.4
Bankruptcy (personal)	14.5
Governmental or administrative matters, including public benefits	13.6
Misdemeanors	13.2
Traffic matters	11.6
Divorce	11.6
Family matters	10.1
Real Estate	7.1
Landlord/Tenant	7.1
Consumer matters - including debt problems	5.9
Wills	5.7
Court representation	4.3
Office work	1.5

The one area of exception is in coverage provisions for the costs/expenses of litigation, where fewer individual payment plans provide coverage. Table 2.12 displays only those legal problems in which coverage differs by source of funding, showing the percent of plans providing coverage for those specific legal problems.

An examination of the breadth of coverage by delivery system produced reliable data only for open and closed panel plans. By a small margin (an average of less than 8 percentage points) open panels appeared to provide broader coverages than closed panels. The areas of major differences were in bankruptcy, tax representation and costs/expenses. In bankruptcy, 86.7% of open panel plans provided coverage as compared with 67.7% of closed panels. Seventy-nine percent of open panel plans indicated they provided coverage for tax representation while only 29% of closed panels indicated that they did so. Also, 70% of open panels provided coverage for the costs and expenses of

TABLE 2.12 BENEFIT COVERAGE DIFFERENCES (ONLY) BY SOURCE OF FUNDING

	Percent of Plans Providing Coverage to Members		
Legal Problem	Employer-Funded Plans	Employee (Dues) Association*	Individual Payment Plans
Family/divorce	76.5	37.5	91.4
Probate	56.3	37.5	88.5
Personal injury	37.5	42.9	64.7
Misdemeanors	68.8	50.0	88.6
Felony-Arraignment	56.3	37.5	80.0
Felony-Trial	52.9	50.3	71.9
Juvenile matters	58.8	25.0	85.7
Traffic matters	58.8	37.5	91.4
Governmental/Admin.	52.9	50.0	93.8
Tax return filings	6.3	25.0	11.4
Tax representation	29.4	25.0	61.8
Costs/expenses	62.5	62.5	54.5

*The small number of cases in this category produces less reliable figures.
Cell sizes were too small to yield reliable data for other sources of funding.

litigation as compared with 51.7% for closed panels.

As for extent of coverage, the plans split fairly evenly on whether the benefits are subject to a ceiling on the total dollar amount of usage available per member per year. Those using a dollar ceiling comprise 47.2% of different plan types. Plans may use hourly or service limitations (i.e., five legal matters per year) instead of dollar ceilings. The fact that 52.8% of plans do not use dollar ceilings does not mean that plan benefits are unlimited. The mean size of the dollar ceiling for all plans using them is $2,947. A breakdown of mean size of the dollar ceiling by plans funding types is as follows:

Source of Funding	Mean Size of Dollar Ceiling
Employer-funded, collective bargaining	$3560.
Employer-funded, unilateral	$2215
Individual Payment Plan	$3240

There is no sufficient data to determine a mean dollar ceiling for the employee association plans.

A note of caution is warrented in the conclusion that may be drawn from the dollar ceilings about the general level of benefits within categories of plans. Plans may utilize a variety of limitations and restrictions so that the dollar ceiling becomes relevant only under certain circumstances. For example, a plan may have a ceiling of $10,000 dollars on felony murder cases, and $2000 on all other types of cases. For another example, two plans may have the same dollar ceiling, $5000, but one may provide litigation coverage only in defense matters and another may also include selective plaintiff coverage. Dollar ceilings, therefore, are only one indicator of the extent of coverage.

Limited information is available on the use of copayments and deductibles by the plans. Forty percent of the plans do utilize copayments or deductibles. Their use is spread very evenly across plans of different funding sources. The legal matter category most often involving a copayment or a deductible is court representation. The mean size of the copayment or deductible for this benefit is $25/year.

2.6 Eligibility for Plan Coverage

In this section and the previous section (Section 2.5) no effort has been made to weight for plan clusters. The use of the term "plan" is this section refers to different plan types, and is not weighted for multiple plans of a similar type.

Plan eligibility provisions differ considerably depending on the type of organization sponsoring the plan or plan funding type. Eligibility provisions tend to be broader for plans forming part of a wage compensation package than for plans forming part of a package of membership services. Additionally, plans provided on an individual enrollment basis tend to have fairly generous provisions. Of course, individual payment plans which are not marketed in an employment context have virtually no eligibility restrictions; any person is eligible for service benefits who pays the premium. In the construction of Table 2.13 certain individual payment plans have been excluded for this reason.

Table 2.13 reports eligibility information on five different categories of potential covered persons by source of funding of the plan. In addition to the principal covered employee or member, a smaller number of plans also extend full or partial coverage to part-time employees. The high percentage of employee association plans funded through general revenues extending eligibility to part-time employees is somewhat anomalous and may reflect the small number of cases in the category.

TABLE 2.13 PLAN ELIGIBILITY PROVISIONS BY SOURCE OF FUNDING

Funding Type	Part-time Employees	Retirees	Spouses & Dependents	Officers	Owners & Shareholder
Employer-funded Plans (collective bargain.)	41.2%	35.3%	100.0%	35.3%	23.5%
Employer-funded Plans* (Unilateral)	25.0%	25.0%	100.0%	100.0%	50.0%
Employee Association (Dues)	44.4%	33.3%	66.7%	11.1%	0.0%
Employee Association* (general revenue)	50.0%	33.3%	50.0%	--	16.7%
Individual Payment	40.9%	45.5%	59.1%	43.2%	25.0%

*Small number of cases

A fourth to one-third of all plans reporting extend eligibility for benefits to retirees.

The high proportion of individual payment plans extending eligibility to retirees is understandable; membership in the plan would be extended equally to active and retired employees since the employee is responsible for making payment to the plan.

Employer-funded plans universally extend coverage to spouses and dependents. (It was discovered that there is no difference in treatment between spouses and dependents and therefore they are treated as a single category of eligible.) Employee association plans are less likely to provide coverage to spouses and dependents although at least 50% do. This may be explained in part by the fact that many of these plans provide employment-related legal services.

Plans were asked whether officers, owners and shareholders were eligible to become members of the plans. It is significant that plans funded unilaterally by employers extend services to these categories of persons more often than do employer plans established through collective bargaining. However, some caution is required because of small frequencies. Employee association plans tend not to cover officers of their organizations.

Only 25% of all plans utilize a waiting period before plan members are eligible to use plan services. Individual payment plans were most likely to use waiting periods; 23.7% of those plans reported utilizing them.

Table 2.14 provides information about plan termination provisions. As might be expected, the three most common contingencies resulting in termination of plan membership were death, termination of employment, and retirement. Approximately 1/5 of all plans extend coverage to members on lay-off for a specific period of time after lay-off. Certain plans which were established in the early to mid 1970's almost universally extended eligibility to the spouse and dependents of a member who had died. Today, a small but still significant number of plans, 16.7%, have such a provision. These provisions appear to represent an effort to provide services to members and employees when they are most in need of them; employees on lay-off tend to experience substantial debt problems and widowed spouses experience significant problems associated with probate, real estate, and guardianship.

TABLE 2.14 TERMINATION PROVISIONS

Type of Provision	Percent of Plans
Immediately in the lay-off of the member	22.6
A specified amount of time after lay-off of member	19.4
On retirement of member	54.8
On termination of member's employment	64.5
On termination of membership in union or employee association	25.8
At death of plan member	77.4
Other	12.5

2.7 Age and Utilization Experience of Plans

Legal service plans have a very recent history. The first real growth in plans occurred only in 1973, and has continued at an increasing rate in succeeding years. Fewer than 8% of the plans, all of them funded by either employee association or individual payment, were established prior to 1973. Using 1980 as a base year, Table 2.15 shows the ages of plans in the study population. (Plans established in 1979 and 1980, 12.8% of the study population, were excluded since only a small proportion of the total number of plans established in these years would have been included in the study population.)

TABLE 2.15 AGE OF PLANS (BASE YEAR: 1980)

Plan Ages	Percent in Age Group
Two years old (established in 1978)	32.3%
Three years old (established in 1977)	21.2%
Four years old (established in 1976)	9.7%
Five years old (established in 1975)	16.7%
Six years old (established in 1974)	6.1%
Seven years old (established in 1973)	3.5%
More than seven years (established prior to 1973)	9.9%

Table 2.16 reports the total number of plans established by year and by source of funding, grouped by major funding type.

The first employer-funded plans in the study population were established in 1974. These plans comprised more than half of the plans established that year. The year 1975 was the first year showing a substantial increase in the number of individual payment plans. These plans increased from a 25% share of plans established in 1974 to better than a 60% share of plans established in 1975. They have consistently comprised a large proportion of plans established. As Table 2.16 shows, employer-funded plans have consistently been established at a rate two to three times greater than employee association plans. The number of employer and employee association plans established together only in 1976 has exceeded the number of individual payment plans established. The year 1976 appeared to be a year when fewer plans were established for all categories except employer-funded plans.

TABLE 2.16 PLANS BY SOURCE OF FUNDING AND DATE ESTABLISHED

Number Percent Row Percent Column	Pre-1973	1973	1974	1975	1976	1977	1978	Total
Employer-funded plans	--	--	7	8	10	8	13	46
(Types 1&2)			15.2	17.4	21.7	17.4	28.3	23.2
			58.3	24.2	45.4	19.0	20.3	
Employee Association	15	3	2	4	3	2	7	36
(Types 3&4)	41.7	8.3	5.6	11.1	8.3	5.6	19.4	18.2
	83.3	42.9	16.7	12.1	13.7	4.8	10.9	
Individual Payment	3	3	3	20	9	32	41	111
(Types 5&6)	2.7	2.7	2.7	18.0	8.1	28.9	36.9	56.1
	16.7	42.9	25.0	60.7	40.9	76.2	64.1	
Other	--	1	--	1	--	--	3	5
(Types 7)		20.0		20.0			60.0	2.5
		14.2		3.0			4.7	
TOTAL	18	7	12	33	22	42	64	198
	9.1	3.5	6.1	16.7	11.1	21.2	32.3	

Very limited data is available about plan utilization experience. Because the pretests revealed that closed panel plans tend to keep records on the basis of number of cases open and open panels on the basis of number of claims paid, different experience questions were constructed for open and closed panel plans reflecting these major differences in recordskeeping. Means were calculated for the number of cases and claims in 1977, 1978 and 1979. In the calculation of mean number cases for closed panel plans, however, there was no control for size of plan and the resultant mean is very large with an extreme positive skew because of the extreme sizes of some of the responding plans. Consequently no meaningful figure is available for the number of cases handled by closed panel plans.

Open panel plans are far more uniform in size and the values for the mean number of claims paid were considered to be reliable. They are as follows:

1977	139.2	claims paid per plan
1978	149.1	claims paid per plan
1979	162.4	claims paid per plan

These values are not inconsistent with the mean size for open panel plans of 314.7 persons per plan.

2.8 Plan Costs

Plans were asked about the amount of the contribution received by the plan on behalf of each member. The mean plan contributions, by funding source, are found in Table 2.17. The mean plan cost per member per year, across all plans, was found to be $78.73. Considerable difficulty was experienced by the plans in responding to appropriate questions on the mail questionnaire. Some appeared to think that the question asked for the aggregated contribution to the plan on behalf of all members rather than a per member per year amount. Accordingly, it was necessary for a plan expert to manually examine all responses to this question in order to identify incorrect data values. When incorrect values were identified, the procedure required them to be excluded from the group of responses, since there was a substantial risk of incorrectly calculating a per member per year figure based upon other data provided in the questionnaire.

One factor, the presence of telephone advice and consultation plans, is believed to have depressed the cost figure for individual payment plans. Telephone advice and consultation plans report their costs to be in the range of $30 to $45 per person per year. Nearly 20% of the study population consists of this type of plan. While no cross tabulation was done for cost by type of benefit structure, this study as well as plan literature indicates that telephone advice and consultation plans are frequently funded through individual payment plans, and also by employee association plans, but almost never by employer-funded plans. Accordingly, the cost figures for employer-funded plans can be characterized as covering plans uniformly providing comprehensive benefits, while cost figures for employee association plans include plan providing less broad benefits as well as plans providing telephone advice and consultation benefits. The cost figures for individual payment plans must be viewed as covering a mixture of both plans with comprehensive benefits, and plans providing telephone advice and consultation benefits.

TABLE 2.17 MEAN AMOUNT OF CONTRIBUTION, PER MEMBER PER YEAR, BY FUNDING SOURCE

Funding Source	Amount
1. Employer-funded, collective bargaining	$ 87.00
2. Employer-funded, unilateral	$102.00
3. Employee association, dues	$ 43.43
4. Employee association, general revenues	No data available
5. Individual Payment plans (voluntary)	$ 74.11
6. Individual Payment plans (mandatory)	No data available
7. Other	$ 84.00
For all plans,	$ 78.73

Plans were also asked whether additional contributions were required for members or employees with spouses and dependents. More than 92% of the plans indicated that no additional contribution was required. For those requiring additional contributions, the amount of the contribution ranged between $16 to $24.

One of the objectives of the study was to collect baseline data on the costs of open and closed panel plans in order to determine whether delivery system was a factor influencing plan cost. While some data was collected on direct and indirect plan costs, it is not sufficient to begin to undertake any examination of the delivery system question. Instead, the authors refer interested readers to a study presently being conducted under the auspices of the American Bar Association Prepaid Legal Services Committee by Professors Richard J. Arnould and Robert W. Resek (University of Illinois) comparing "the cost of staff panel and participating attorney panel prepaid legal service plans".

2.9 Summary and Profile of Plans

The study population is a subset of the universe of plans, and consists of approximately 60% of the universe. Insurance plans are underrepresented in the study population. Otherwise, it is beleived to be representive of the universe of plans. All of the plans in the study population have the following characteristics:

-- the plan is established, maintained or funded by a group, such that the group sponsors, collects funds, administers, or performs some function in connection with the plan;

-- the group associated with the plan is employment-related, consisting of either an employer, an employee association, or some other employment related organization;

-- the plan involves prepayment for services at the rate of $5.00 per member per year or more.

The plans include many diverse types and structures. The most important plan variable is source of funding. Three major and three minor funding categories were identified; the major categories include employer-funding, employee association (or union) funding, and individual payment. An important but secondary variable is delivery system.

Only the union or employee association plans have been in existence for any length of time; 41% of these plans in the study population were established prior to 1973. The first employer funded plan was not established until 1974 and individual payment plans did not begin to increase quickly until 1975.

Based on 215 plans reporting membership figures, 19.1% of the plans were employer-funded; these plans covered 59.7% of the people participating in plans. Union or employee plans counted for 16.9% of plans and 36.1% of people participating in plans. These two groups of plans account for 95.8% of people participating in prepaid legal service plans. The third category, individual payment plans, account for a substantial 64% of plans but only 4.2% of covered persons.

The mean size of plans (correcting for three extreme cases) is 1,393 persons per plan. The plans can be found in every region of the country, though not in every state. Considering only plans established by employers and employee associations, the mean plan size is 2,915 per plan.

The study population is characterized by a large number of extremely small individual payment plans and a smaller number of substantially larger employer and employee association plans. The employer and employee association plans include a number of extremely large plans, each of which is four or five times larger than the next largest plan in each group.

With the exception of plans providing primarly telephone advice and consultation benefits, benefits provided under all plans are reasonably comprehensive in scope. Only union or employee association plans provide more somewhat limited benefits.

In addition the following analysis revealed the following findings:

1. The most common areas of coverage provided by more than 85% of all plans were advice, real estate matters, wills, and consumer matters. Divorce was provided by nearly 80% of the plans.
2. A substantial majority of the plans provided coverage for juvenile, traffic, misdemeanors and felony criminal matters.
3. Probate and personal injury coverage, both traditionally provided on a contingent fee basis, are covered in some way by a large proportion of the plans (69.1% and 56.3% respectively).
4. Approximately half of the plans provide some coverage for the non-fee costs associated with legal services.
5. Nearly half of the plans will provide representation in tax court but few provide tax preparation services.
6. A substantial proportion of plan coverage involve legal matters where the government is a party or is being petitioned to grant some privilege or status.

A large proportion of plans extend eligibility to persons other than the primary participant. Spouses and dependents are most often covered, usually with no additional contribution or premium payment required. Retirees and part-time employees are also covered by a substantial number of plans. Unilaterally employer-funded plans are the only plans extending eligibility to officers, owners and shareholders in any significant proportion.

The second major plan variable, delivery system, provided an interesting but incomplete picture of the factors with which different delivery systems are associated. It was found that the open panel delivery mechanism, when correlated with size, has not been used by larger plans; 62% of plans use closed panel or staff delivery systems and 33% use a mixture of open and closed panel systems, leaving fewer than 5% of the plans utilizing only open panels to deliver services. Union and employee association plans and individual payment plans strongly favor closed or staff delivery systems. Employer-funded plans are evenly divided between open panel plans and closed or staff plans.

By a small margin, open panel plans do appear to provide benefit packages including slightly broader coverage (i.e., specifically covering more legal matter). This is partially a function of the type of benefit structure, however, since many closed panels use an Hour Bank approach which does not limit coverage to specified legal matters.

The mean plan cost, across all plans, is $78.73 per person per year.

Following are brief profiles of major types of plans, categorized by sources of funding.

Employer-funded plans established through collective bargaining - These plans first appeared in 1974, after a 1973 amendment to the Taft-Hartley Act made legal service plans a legitimate subject of collective bargaining. Their mean size is 4,651 persons per plan. At least one employer-funded plan is national in scope. Due mainly to the large size of the 1 plan, plans of this type account for nearly 60% of the persons presently participating in a prepaid legal service plan.

Employer-funded plans established through collective bargaining employ all of the different benefit structures which have been identified. The plans are evenly divided between open and closed panel delivery systems. Benefits are extended not only to employees but also to the spouses and dependents of employees. One-third of the plans extend eligibility to part-time employees and more than half also cover retirees. Fewer than a third extend coverage to officers, owners, or shareholders. For those plans using a dollar ceiling as a limitation on use, the mean amount of the ceiling is $3,560 per year, a higher figure than for plans of any other funding source. The mean cost per person per year is $87.

Employer-funded plans established unilaterally by employers - These plans comprise the smallest type of plan, with a mean size of 50 covered persons per plan. They do not yet constitute a significant class of plans either in numbers of plans established or in numbers of persons covered. Similar to plans established through collective bargaining, the first unilaterally employer-funded plan was not established until 1974.

Legal services are provided through both open and closed panel delivery systems. Like the collectively bargained employer plans, spouses and dependents are provided coverage in all plans. Part-time employees are extended coverage in only 20% of the plans. However, the plans do provide coverage for retirees, officers, owners and shareholders 10 to 20 percent more often than collectively bargained plans. These plans have a dollar ceiling of $2,215 and cost $102 per person per year. This is the lowest ceiling and the highest cost per plan for which figures were available.

Union or employee association (dues) plans - This category of plans constitutes 12.5% of plans and 34.8% of persons participating in plans, making it the second most important category of plans. The mean size (corrected) of dues-funded plans is 2,965 persons per plan; there is at least one extremely large plan included in the category.

The dues-funded plans differ in character from the employer plans in that their primary purpose is to serve members, not to compensate employees. Also, they are plans where the members, directly or indirectly through an elected representative, vote on whether to tithe themselves to pay for the program; the dues contribution comes directly out of the members pocket and is not subject to any kind of favored tax treatment.

These plans are usually provided on a closed panel or a staff basis. All kinds of benefit structures are found among the dues-funded plans, including plans providing primarily advice and consultation.

Two-thirds of the plans extend coverage to spouses and dependents and one-third extend coverage to retirees. Benefits are also somewhat limited than in employer-funded plans, covering fewer legal matters. (However, many dues plans utilize the Hour Bank benefit structure, which does not specify the legal matters which may be handled.) The mean cost of dues-funded plans is also lower, at $43.40 per person per year.

Union or employee association (general revenue) plans - Like the unilaterally employer-funded plans, union or employee association plans provided through general revenues do not constitute a significant category of plans in terms of either numbers of plans or numbers of persons covered. The mean size of plan is only 814 persons. The small mean size compared to dues funded plans makes it difficult to characterize these groups except to say that they are small employee association groups with sufficient treasuries to fund their legal service plans out of general revenues without the necessity of having to seek a dues increase to fund the plan.

Legal services are provided using all kinds of benefit structures, but services are usually provided on either a closed or a staff panel basis. Spouses and dependents are covered in not quite two-thirds of these plans. Part-time employees are also covered in not quite two-thirds of the plans. This is a high proportion compared to other funding sources. Fifty percent of the plans funded through general revenues include retirees. Only 25% extend coverage to officers of the group.

No data is available on the mean cost per person per year.

Individual payment plans (voluntary and mandatory) - Because there are so few mandatory payment plans, they have been grouped for purposes of discussion, with the voluntary plans.

These plans constitute the largest category of plans, more than 60%, and are perhaps the mose diverse. However, individual payment plans also constitute a relatively small type of plan, with a mean size of approximately 200 persons per plan, and contain less than 5% of the total number of persons participating in prepaid plans.

In some cases these individual payment plans will not be plans subject to ERISA because they are not "established or maintained by an employer" as that phrase is interpreted by the Department of Labor and the court. Yet they are plans established in an employment context with a sufficient nexus to the employment group to be considered a group plan; importantly, the employers were aware of the plans and their employees' participation in it. These plans were included in the study population because of their potential for conversion to employer funding in the future.

Most of the individual payment plans could be characterized as "commercial" legal service plans. They are marketed to many different groups and often are centrally administered. Nearly three-fourths of these plans form part of a plan cluster. For some of these plans, the sponsoring group is an employer credit union; approximately 20% are advice and consultation plans.

By a three to one margin these plans provide services on a closed panel or staff basis; they include all of the different benefit types. Because plan participants individually pay their contribution or premium, individual payment plans have no reason to restrict coverage unless a client group requests that they do so. Nor surprisingly, therefore, individual payment plans have broad eligibility guidelines.

Benefits under individual payment plans appear to be extremely carefully defined and generally quite broad, extending to a wide range of legal matters. Also, dollar ceiling is comparatively high at $3,240. The mean cost is $74 per person per year, although this figure probably represents a mixture of low cost advice and consultation plans and higher cost comprehensive benefit plans.

UAW LEGAL SERVICES PLAN:

COMPARATIVE ANALYSIS OF 1981 CLIENT SATISFACTION QUESTIONNAIRE RESPONSES

	STAFF OFFICES	STAFF AREA COOPERATING ATTORNEYS*	NON-STAFF COOPERATING ATTORNEYS**	TOTAL
Total Sent	12,928	1,926	360	15,214
Total Returned	3,899	380	128	4,407
% of Total Returned	30.2%	19.7%	35.6%	29.0%
Value:				
- Very	89.3%	76.6%	92.5%	88.3%
- Fairly	8.8%	18.4%	5.8%	9.5%
- Not	1.9%	5.0%	1.7%	2.2%
Courteous Attorney:				
- Yes	98.9%	96.9%	100.0%	98.9%
- No	1.1%	3.1%	0.0%	1.2%
Courteous Staff:				
- Yes	98.7%	99.2%	100.0%	98.8%
- No	1.3%	0.8%	0.0%	1.2%
Kept Informed:				
- Very	84.5%	59.3%	83.0%	82.9%
- Fairly	11.7%	25.7%	17.0%	12.6%
- Not	3.8%	15.0%	0.0%	4.5%
Satisfied:				
- Very	88.3%	64.8%	86.1%	86.9%
- Fairly	7.6%	19.4%	12.9%	8.4%
- Not	4.1%	15.8%	1.0%	4.7%
Use Attorney Again:				
- Yes	96.5%	82.5%	98.0%	95.7%
- No	3.5%	17.5%	2.0%	4.3%
Written Comments:				
- Yes	45.7%	32.9%	40.6%	44.5%
- No	54.3%	67.1%	59.4%	55.5%

---

* Responses for Staff Area Cooperating Attorneys are from clients who hired the CA.

** Responses for Non-Staff Area Cooperating Attorneys are from clients who hired the CA, whose cases opened between January and June, 1981. (Beginning July 1981, these clients were surveyed as their cases closed; their responses are not included here.)

SURVEY OF CLIENTS
OF UAW LEGAL SERVICES PLAN ATTORNEYS

1. How valuable do you think the UAW Legal Services Plan is to its Participants?
   - Very valuable ☐
   - Fairly valuable ☐
   - Not valuable ☐

2. Were you courteously treated by:
   - The attorney? ☐ Yes ☐ No
   - Persons working in the attorney's office? ☐ Yes ☐ No

3. Did your attorney clearly explain your legal matter and the steps needed to resolve it? ☐ Yes ☐ No

4. How well did your attorney keep you informed about what was happening with your legal matter?
   - Very well informed ☐
   - Fairly well informed ☐
   - Not well informed ☐

5. How satisfied are you with the work your attorney did for you?
   - Very satisfied ☐
   - Fairly satisfied ☐
   - Not satisfied ☐

6. Would you want to use your attorney again? ☐ Yes ☐ No

7. Please use the space below to make suggestions for making the program better and to list any criticism or praise. If you answered "No" or "Not" to any of the above questions, we would be especially interested in your comments.

Continue on other side if necessary

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UTILIZATION STATISTICS:
UFCW DISTRICT UNION LOCAL 1, UTICA, N.Y.

Source: 4 year report presented July 29, 1982 to the Executive Board and Staff by Ass't Fund Manager Patrick D. Cannistra.

LEGAL UTILIZATION FROM INCEPTION

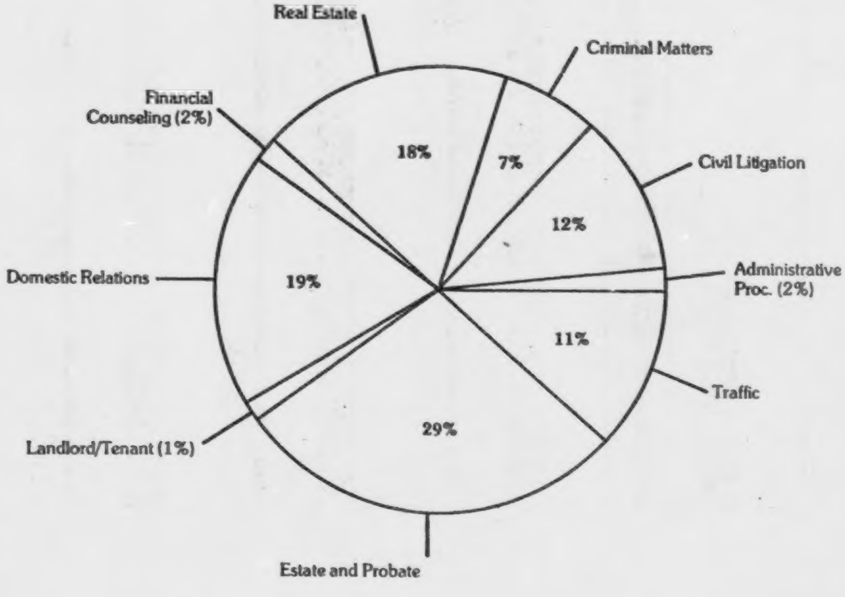
Overall utilization over the last four years has remained quite consistent except in the real estate area. Due to an increase in interest rates and the unavailability of mortgage money, it appears that the trend towards a decrease in the real estate area will continue.

Domestic relations cases have fluctuated between 17-20%, whereas estate and probate utilization shows a high of 34% for 1978 and a low of 23% for 1980.

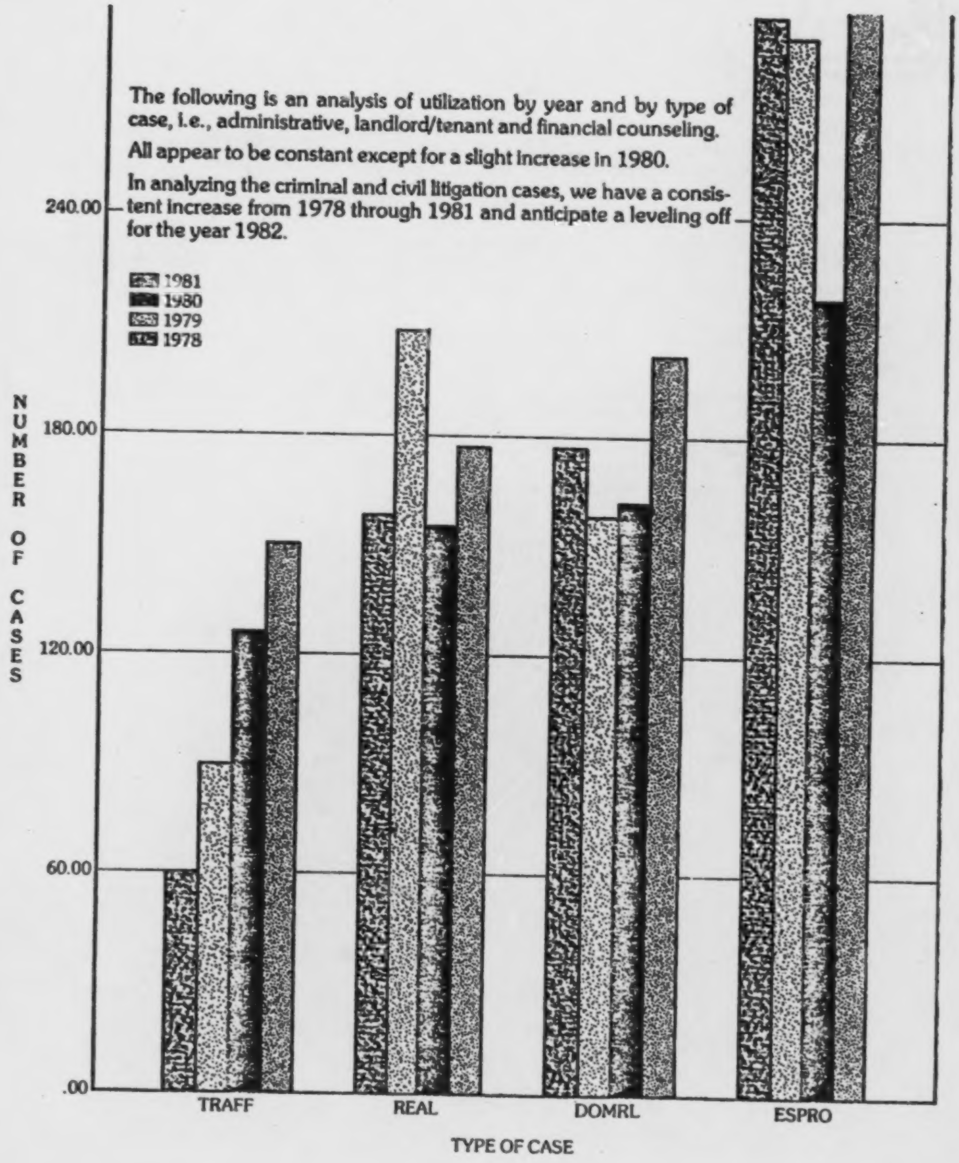
We will continue to saturate the field with the importance of every full-time and part-time member having a will.

All the other areas remain constant with a fluctuation of about 1%. With the availability of these statistics, we can estimate the trend for the future and focus in on a weak area which we may notice.

LEGAL UTILIZATION - FROM INCEPTION
(% of total cases)



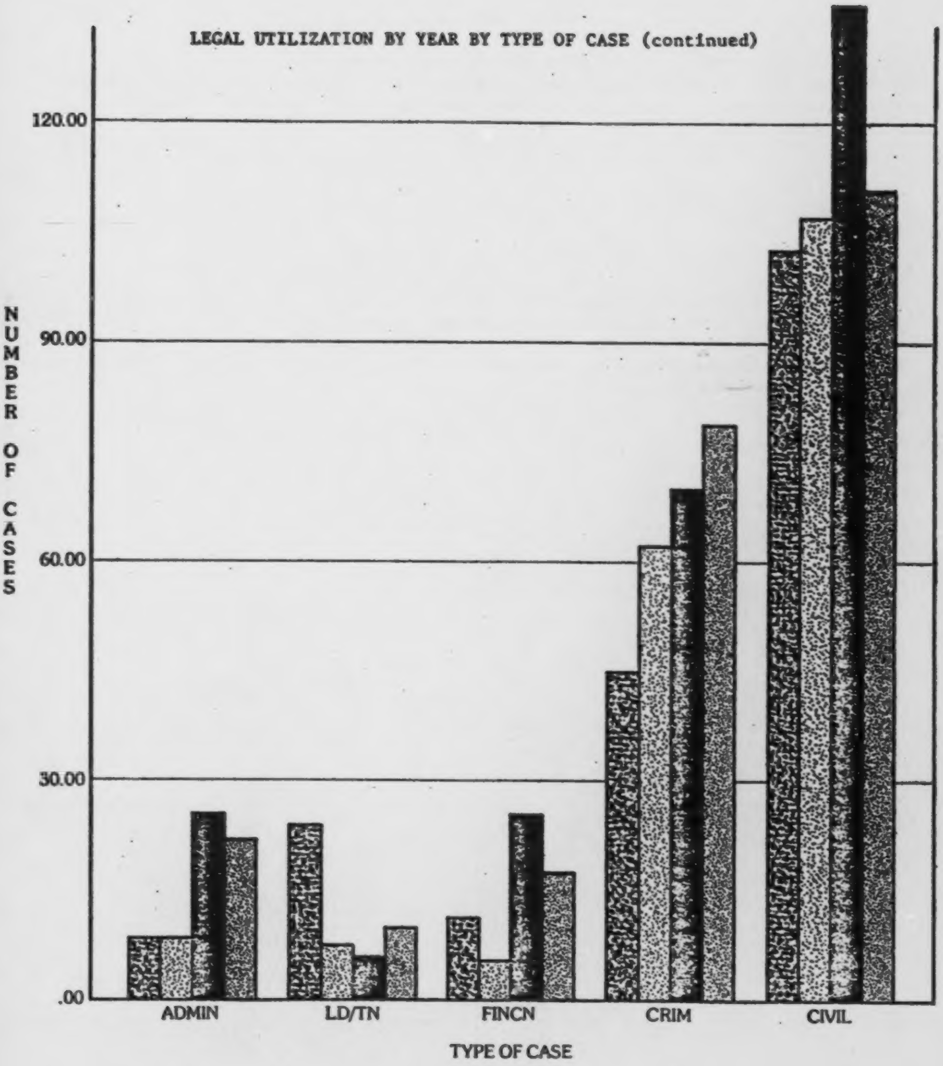
LEGAL UTILIZATION BY YEAR BY TYPE OF CASE



The following is an analysis of utilization by year and by type of case, i.e., administrative, landlord/tenant and financial counseling.

All appear to be constant except for a slight increase in 1980.

In analyzing the criminal and civil litigation cases, we have a consistent increase from 1978 through 1981 and anticipate a leveling off for the year 1982.



TAX PREPARATION

In January, 1981, Income Tax Preparation was introduced and added to the Group Legal benefits. Utilization was relatively low due to several factors which included filling out a lengthy questionnaire and providing a minimal number of locations with tax preparers.

In an effort to increase utilization of this worthwhile benefit, the questionnaire was discarded and 32 locations were provided throughout New York State to minimize travel for our members. The result was evident. In 1981, only 431

(continued on p. 4)

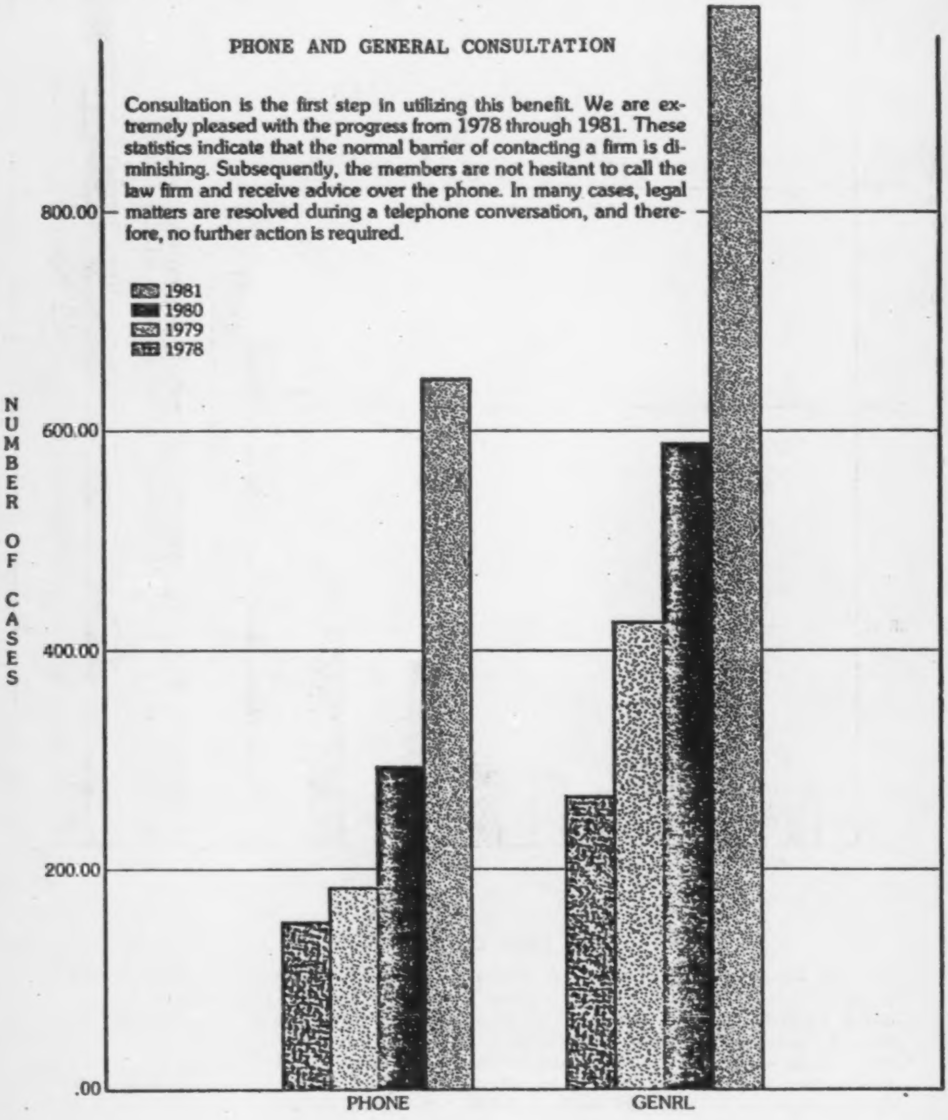
TAX PREPARATION (con't) members had their taxes prepared. In 1982, 1334 members utilized the tax preparation service. This amounted to a 310% increase. Of the 1334 returns, 625 were long form and 709 were short form.

We look forward to another significant increase in 1983 as we provide better accessibility to tax preparers and contact and inform more members about the tax preparation benefit.

*****

PHONE AND GENERAL CONSULTATION

Consultation is the first step in utilizing this benefit. We are extremely pleased with the progress from 1978 through 1981. These statistics indicate that the normal barrier of contacting a firm is diminishing. Subsequently, the members are not hesitant to call the law firm and receive advice over the phone. In many cases, legal matters are resolved during a telephone conversation, and therefore, no further action is required.



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SHREVEPORT PLAN UTILIZATION STATISTICS

No other plan can boast utilization statistics going back 12 years! We're pleased to present excerpts from the statistical appendix to Laborers Local 229's Legal Service Plan plan booklet.

The country's oldest prepaid plan continues to be funded at 2¢ per hour through union dues.

A. GROSS RECAPITULATION FOR FOUR YEARS

1971 - 1974

	INTAKE	NO. CLAIMS	DOLLARS CLAIMS	AVERAGE CLAIM
1971	108	30	$ 6,360	212
1972	76	56	12,529	223
1973	74	65	15,804	243
1974	105	92	19,479	211
January 1975	6	4	600	150
	369	243	$54,772	225

243	Claims Paid
81	Cases Administratively Closed
45	Cases pending on Feb. 1, 1975
369	

B. FOUR YEAR CLAIMS SUMMARY

JANUARY 1971 - JANUARY 1975

	GENERAL	1971	1972	1973	1974	
(A)	Members certified for usage	108	76	74	105	
(B)	Percentage of usage (family unit)	20%	14%	14%	20%	
(C)	Files closed with fee charged	31	56	65	92	
	ANALYSIS OF CLAIMS PAID:					
	CATEGORIES OF CASES	# %	# %	# %	# %	AVG.
(A)	Domestic Relations	14-45.2	7-12.5	10-15.4	28-30.5	26
(B)	Automobile (all inclusive)	5-16.2	14-25.0	25-38.5	24-26.1	26
(C)	Retail credit & consumer problems	2- 6.4	4- 7.2	3- 4.6	6- 6.5	6
(D)	Bankruptcy	2- 6.4	5- 9.0		5- 5.5	6
(E)	Successions	1- 3.2	7-12.5	2- 3.1	4- 4.3	6
(F)	Employment Compensation		8-14.2	1- 1.5	1- 1.1	4
(G)	Workmen's Compensation		2- 3.5	2- 3.1	1- 1.1	2
(H)	Port			1- 1.5		½
(I)	Criminal		3- 5.3	13-20.0	18-19.5	11
(J)	Juvenile	1- 3.2				1
(K)	Real Property	5-16.2	5- 9.0	7-10.8	4- 4.3	10
(L)	General Contract Problems		1- 1.8			½
(M)	Insurance (other than auto)			1- 1.5		½
(N)	Administrative Law				1- 1.1	½
(O)	Unknown	1- 3.2				
		31-100%	56-100%	65-100%	92-100%	100%

→

FIVE YEAR CASE AVERAGE
1975 – 1980

CATEGORY	PER CENT
Domestic Relations	24
Automobile (all inclusive)	30
Consumer Problems	4
Bankruptcy	2
Successions	7.3
Unemployment Compensation	1
Worker's Compensation	0.4
Tort	2
Criminal	13
Juvenile	3.2
Real Property	9
General Contract Problems	1
Insurance (Other than auto)	1
Administrative Law	0
Unknown Social Security	2
	99.9%

LABORERS LOCAL NO. 229 LEGAL SERVICE PLAN
FIVE YEAR CLAIMS SUMMARY
March, 1975 – February, 1980

	3/1/75-2/19/76		3/1/76-2/28/77		3/1/77-2/28/78		3/1/78-2/28/79		3/1/79-2/19/80	
		A		A		A		A		A
CATEGORIES OF CASES	No.	% of Total Cases	No.	% of Total Cases	No.	% of Total Cases	No.	% of Total Cases	No.	% of Total Cases
(A) Domestic Relations	10	21	15	23.4	8	16.4	14	40	5	17.9
(B) Automobile (all inclusive)	11	23	26	40.6	14	28.6	10	28.5	8	28.6
(C) Retail Credit & Consumer Problems	1	2	1	1.6	1	2	1	2.85	3	10.7
(D) Bankruptcy	1	2			2	4.1			1	3.5
(E) Successions	4	8.3	4	6.2	4	8.2	5	14.28	2	7.1
(F) Unemployment	1	2	1	1.6						
(G) Workmen's Compensation	1	2								
(H) Tort					2	4.1			1	3.5
(I) Criminal	12	25	6	9.4	5	10.3			5	17.9
(J) Juvenile	4	8.3	1	1.6	3	6.2				
(K) Real Property			2	3.1	10	20.1	4	11.42	2	7.1
(L) General Contract Problems	1	2.0	1	1.6						
(M) Insurance (other than auto)	1	2.0	2	3.1						
(N) Administrative Law			3	4.7						
(O) Unknown	1	2.0	2	3.1			1	2.85	1	3.5
TOTALS	48	99.60%	64	100%	49	100%	35	99.90%	28	99.80%

(continued)

LABORERS LOCAL. NO. 229 LEGAL SERVICE PLAN
FIVE YEARS CLAIMS SUMMARY
March, 1975 – February, 1980

		3/1/75-2/29/76		3/1/76-2/28/77		3/1/77-2/28/78		3/1/78-2/28/79		3/1/79-2/29/80	
			B		B		B		B		B
CATEGORIES OF CASES		Money	% of Total Paid	Money	% of Total Paid	Money	% of Total Paid	Money	% of Total Paid	Money	% of Total Paid
(A)	Domestic Relations	2,846	26.3	3,428	25.1	1,905	14.5	2,544.78	32.45	1,795.20	24
(B)	Automobile (all inclusive)	2,875	26.6	5,778.95	42.3	3,512	26.8	3,038.75	38.76	2,210	29.6
(C)	Retail Credit & Consumer Problems	82	.7	75	.6	30	.2	240	3.06	692	9.3
(D)	Bankruptcy	265	2.4			705	5.4			475	6.4
(E)	Successions	605	5.6	1,237.50	9.1	377	2.9	1,547.50	19.74	188	2.5
(F)	Unemployment	100	.9	50	.4						
(G)	Workmen's Compensation	215	2.0								
(H)	Tort					437	3.6			50	0.7
(I)	Criminal	2,952	27.3	1,850	13.6	3,145	23.5			1,350	18.1
(J)	Juvenile	453	4.2	300	2.2	425	3.2				
(K)	Real Property			120	.9	2,565	19.5	379	4.83	559	7.5
(L)	General Contract Problems	42	.4	236	1.7						
(M)	Insurance (other than Auto)	128	1.2	115	.8						
(N)	Administrative Law			155	1.1						
(O)	Unknown	242	2.2	306	2.2			90	1.14	140	1.9
	TOTALS	10,805	99.80%	13,651.45	100%	13,101	99.60%	7,840.03	99.98%	7,459.20	100%

RECAPITULATION OF CLAIMS EXPERIENCE

Fiscal Year March 1, 1980
Through
February 29, 1981

	No. of Claims	Advice	Office Work	Court	Major
1. Domestic Relations	15	90.00	1,800.00	2,738.80	60.00
2. Automobile	6		330.00	985.00	
3. Consumer Problems	1	25.00			
4. Successions, Descent & Distribution to heirs	5	100.00	530.00	1,126.33	
5. Unemployment Compensation	1		257.50	349.40	
6. Workmen's Compensation	0	0	0	0	
7. Criminal	3		355.00	1,164.00	3,108.80
8. Juvenile	0	0	0	0	0
9. Real Property	5		663.00	45.00	
10. Unknown	1	45.00			
Totals	37	$260.00	$3,935.50	$6,408.53	$3,168.80

Total Claims 37
Total Expense $13,772.33

RECAPITULATION OF CLAIMS EXPERIENCE

Fiscal Year March 1, 1982
Through
February 28, 1983

	No. of Claims	Advice	Office Work	Court	Major
1. Domestic Relations	8	-0-	1,521.25	2,830.00	-0-
2. Automobile	10	50.00	1,002.50	1,260.00	-0-
3. Consumer Problems	1	-0-	165.00	-0-	-0-
4. Successions, Descent & distribution to heirs	1	-0-	133.34	-0-	-0-
5. Unemployment Compensation	0	-0-	-0-	-0-	-0-
6. Workmen's Compensation	0	-0-	-0-	-0-	-0-
7. Criminal	4	200.00	480.00	715.00	1,445.00
8. Juvenile	0	-0-	-0-	-0-	-0-
9. Real Property	4	-0-	444.29	150.00	-0-
10. Unknown (Subrogation)	1	-0-	240.00	515.00	-0-
TOTALS	29	250.00	$3,986.38	$5,470.00	$1,445.00

Total Claims 29
Total Expense $11,151.38

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UTILIZATION STATISTICS: LABORERS' LOCAL 423 LEGAL SERVICE

This well known dues-funded plan in Columbus, Ohio is the second oldest in the country. Utilization is the highest we've seen for a true group plan. The plan's five staff attorneys are located in union headquarters. Eligible membership in 1981 averaged 1800, about the same as in prior years.

The 1981 statistics (p.3&4) are presented exactly as they are kept and used by the plan. The 5 year comparison figures are taken directly from the '81 sheets and their counterparts from earlier years. Note that "advice only" matters are not included. Such matters totaled about 120 in 1977 and nearly 500 last year.

Utilization was 57% in 1981, 85% if advice only matters are added in.

CATEGORY	1981	1980	1979	1978	1977*
Dissolution	30	41	35	22	
Divorce	32	25	15	34	
Non-Support	35	36	23	17	
Paternity	7	6	3	6	
Custody Change	9	9	4	7	
Visitation	3	6	0	4	
Other Family	20	18	19	10	
TOTAL DOMESTIC	136	141	99	100	72
Decedent's Estate	5	6	1	1	
Adoption	10	3	8	8	
Guardianship	1	1	1	4	
Name Change	6	3	4	13	
Birth Proof	16	15	7	6	
Release of Admn.	5	7	3	5	
Wills	32	32	30	32	
Other Probate	3	5	7	8	
TOTAL PROBATE	78	72	61	77	43

(over→)

* In 1977 different categories were used. Cases have been re-assigned to the new categories, but the figures aren't strictly comparable.

(2)

CATEGORY	1981	1980	1979	1978	1977
Torts	28	16	13	9	
Civil/Defendant	36	27	14	15	
Civil/Plaintiff	11	3	8	16	
Auto Consumer Comp.	21	23	22	10	
Consumer Complaints	35	30	34	32	
Contract Matters	42	50	50	47	
TOTAL CIVIL	173	149	141	129	29
BMV Problems	16	32	25	21	
Accident/Uninsured	23	25	12	17	
Accident/Insured	1	8	3	9	
Accident/Property Dmg.	31	40	39	31	
P.I. Claims	1	0	0	0	
Other Civil Traffic	0	1	1	4	
TOTAL CIVIL TRAFFIC	72	106	80	82	49
Landlord/Tenant	29	26	28	27	
House Purch./Sale	24	19	26	35	
Post-Closing Problems	3	2	8	3	
Title Search	2	2	2	0	
Foreclosure	15	7	7	4	
Other Real Estate	41	26	34	20	
TOTAL REAL ESTATE	114	82	105	89	52
Bailbond Card	0	2	2	0	
Jury Demand Filed	0	0	3	0	
OMVI	57	68	65	60	
Serious Traffic	40	57	30	39	
Misdemeanor	40	65	78	66	
Felony	14	22	10	19	
Expungement	1	8	4	3	
Other Traffic	36	58	70	51	
Juvenile	39	19	36	17	
Crim. Non-Support	2	1	2	7	
Other Criminal	13	4	3	3	
TOTAL CRIMINAL	242	304	303	265	190
Workers' Compensation	55	18	0	0	
Crime Claims	1	1	0	1	
Social Security	19	12	3	3	
Taxes	8	12	12	11	
Unemp. Compensation	26	22	14	14	
Other Government	21	11	10	4	
TOTAL GOVERNMENT	130	76	39	33	17
Bankruptcy	42	48	21	6	
Trusteeship	0	0	1	1	
Credit Reports	5	11	16	8	
Payment Plan	6	9	8	16	
Other Debt Problems	35	49	47	35	
TOTAL DEBTS	88	117	93	66	62
Miscellaneous Cases	0	0	0	0	31
TOTAL CASES	1033	1052	921	837	545

LABORER'S LOCAL 423 LEGAL SERVICE STATISTICS FOR THE YEAR 1981

CATEGORY	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL
Dissolution	5	4	2	3	1	4	4	3	0	3	1	0	30
Divorce	2	1	3	2	1	5	3	0	5	5	3	2	32
Non-Support	2	2	1	2	1	4	7	2	3	3	3	5	35
Paternity	0	0	0	2	1	1	1	0	0	0	1	1	7
Custody Change	1	0	1	1	1	0	2	2	0	0	1	0	9
Visitation	1	0	1	1	0	0	0	0	0	0	0	0	3
Other Family	0	1	2	2	4	5	1	1	0	0	1	3	20
TOTAL DOMESTIC	11	8	10	13	9	19	18	8	8	11	10	11	136
Decedent's Estate	0	0	0	0	0	0	1	1	1	0	2	0	5
Adoption	2	3	0	0	1	1	1	0	0	2	0	0	10
Guardianship	0	0	0	0	0	0	1	0	0	0	0	0	1
Name Change	0	0	0	1	0	0	0	4	0	0	0	1	6
Birth Proof	0	1	0	1	1	1	3	3	2	2	0	2	16
Release of Admn.	0	0	0	1	0	0	0	1	1	0	1	1	5
Wills	3	0	5	0	3	2	1	1	2	4	2	9	32
Other Probate	0	1	0	0	1	0	0	1	0	0	0	0	3
TOTAL PROBATE	5	5	5	3	6	4	7	11	6	8	5	13	78
Torts	0	1	9	2	1	4	2	2	2	1	2	2	28
Civil/Defendant	2	1	3	3	5	5	4	4	2	4	3	0	36
Civil/Plaintiff	0	0	2	0	1	3	0	0	0	2	1	2	11
Auto Consumer Comp.	2	0	3	1	3	2	0	0	3	4	2	1	21
Consumer Complaints	5	3	4	4	3	4	3	2	1	1	3	2	35
Contract Matters	4	2	4	1	0	6	8	3	0	7	4	3	42
TOTAL CIVIL	13	7	25	11	13	24	17	11	8	19	15	10	173
BMV Problems	0	2	3	0	0	4	4	1	1	0	1	0	16
Accident/Uninsured	2	1	3	0	1	0	2	4	1	2	2	5	23
Accident/Insured	0	0	1	0	0	0	0	0	0	0	0	0	1
Accident/Property Damage	4	5	4	0	3	1	1	1	1	5	1	5	31
P.I. Claims	0	0	0	0	0	0	1	0	0	0	0	0	1
Other Civil Traffic	0	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL CIVIL TRAFFIC	6	8	11	0	4	5	8	6	3	7	4	10	72

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1981 STATISTICS (continued)

CATEGORY	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL
Landlord/Tenant	2	1	4	3	1	3	6	0	1	3	2	3	29
House Purch./Sale	4	3	4	2	1	2	2	1	3	0	2	0	24
Post-Closing Problems	0	2	0	1	0	0	0	0	0	0	0	0	3
Title Search	0	0	0	1	0	1	0	0	0	0	0	0	2
Foreclosure	1	1	1	1	2	2	1	2	2	0	2	0	15
Other Real Estate	8	1	6	0	8	2	5	2	1	7	1	0	41
TOTAL REAL ESTATE	15	8	15	8	12	10	14	5	7	10	7	3	114
OMVI	2	9	5	3	3	13	3	7	2	2	3	5	57
Serious Traffic	2	2	3	3	4	6	6	3	3	2	5	1	40
Misdemeanor	1	7	4	6	3	4	4	2	3	2	1	3	40
Felony	0	0	1	1	1	2	2	2	0	3	1	1	14
Expungement	0	0	0	0	1	0	0	0	0	0	0	0	1
Other Traffic	3	3	4	5	3	3	2	1	2	3	2	5	36
Juvenile	7	3	1	2	1	5	3	2	4	3	4	4	39
Crim. Non-Support	1	0	0	0	0	0	0	1	0	0	0	0	2
Other Criminal	0	1	0	0	3	3	3	0	1	0	0	2	13
TOTAL CRIMINAL	16	25	18	20	19	36	23	18	15	15	16	21	242
Worker's Compensation	2	4	6	3	4	4	5	9	4	4	3	7	55
Crime Claims	0	0	1	0	0	0	0	0	0	0	0	0	1
Social Security	1	1	2	1	0	1	3	5	3	1	0	1	19
Taxes	0	0	0	0	1	1	1	2	1	0	2	0	8
Unemployment Compensation	2	3	5	3	2	4	0	2	1	1	1	2	26
Other Government	2	3	4	3	1	2	1	0	1	4	0	0	21
TOTAL GOVERNMENT	7	11	18	10	8	12	10	18	10	10	6	10	130
Bankruptcy	3	0	4	1	9	4	2	4	2	3	10	0	42
Credit Reports	1	0	2	0	0	0	0	0	0	1	1	0	5
Payment Plan	1	0	2	1	0	0	1	0	0	0	1	0	6
Other Debt Problems	1	6	4	4	1	3	1	3	5	2	1	4	35
TOTAL DEBTS	6	6	12	6	10	7	4	7	7	6	13	4	88
TOTAL CASES	79	78	114	71	81	117	101	84	64	86	76	82	1033

1981 UTILIZATION DATA

LEGAL SERVICES PLAN, LABORERS' DISTRICT COUNCIL of Washington, D.C. & Vicinity

The D.C. Laborers' plan will celebrate its tenth anniversary next year. The plan has 5 staff attorneys, including administrator Alton Lewis, and is funded by a 10¢/hour dues contribution. Eligible membership in 1981 averaged about 2750 families, but the exact number is unknown, because all members contribute to the plan each hour they work, but only those members working for 400 hours in 2 of the previous 3 calendar quarters may obtain full services. All members are eligible for advice from the first hour they work, and all are eligible for tax preparation.

Advice-only cases are not included in the figures below. Excluding tax preparation, the annual utilization rate is 19.5%.

Benefits are comprehensive. The principal exclusions are: criminal cases (except drunk driving), contingency fee matters (including workmen's compensation), business matters, non-moving traffic violations, and small claims. Court costs are not covered. There is a $200 per case ceiling on payments to private attorneys hired under the opt-out provision.

	TOTAL	PERCENTAGE OF TOTAL	% OF DEC '81 CASELOAD
ATTORNEYS:			
Staff	458	85	80
Retained	78	15	20
CLIENTS SERVED:			
New	147	27	22
Previous	389	73	78
JURISDICTION OF PROBLEM:			
D.C.	264	49	58
Maryland	184	35	29
Virginia	86	16	13
Other	2	0	0
LOCAL UNION BREAKDOWN OF NEW CASES:			
Local # 74	318	53	64
456	143	28	27
764	8	1	0
832	19	4	0
801	2	0	0
691	10	2	0
115	20	4	9
571	8	2	0
999	2	0	0

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TYPE OF CASE	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC	TOTAL	% OF TOTAL	% OF DEC '81 CASELOAD
FAMILY															
Divorce	0	2	2	2	0	3	3	5	5	0	0	4	26	5	8
Separation Agreement	1	1	0	0	0	2	0	0	0	1	0	0	5	1	0
Guardianship/Conservator/ Custody	1	2	1	1	0	0	0	0	1	1	1	2	10	2	5
Adoption	0	0	1	0	1	0	0	0	0	0	0	0	2	0	0
Name Change	0	3	1	2	0	0	0	2	1	0	1	1	11	2	2
Non-Support/Paternity	3	6	4	2	4	2	4	2	1	4	0	0	32	6	0
Proof of Birth	0	0	2	1	1	2	3	0	1	0	0	0	10	2	0
Other Family	0	1	1	3	1	3	1	2	2	1	1	1	17	3	2
WILLS/PROBATE	1	2	6	0	4	6	2	4	3	0	1	1	30	6	2
CREDITOR ACTION	2	3	5	4	1	7	13	3	0	6	5	4	53	10	8
CONSUMER	1	6	2	8	6	7	8	1	3	3	2	4	51	10	8
DWI/ORA/OAS/HABITUAL OFFENDER	11	3	6	3	9	5	6	4	8	11	7	7	80	15	16
TRAFFIC VIOLATIONS	1	1	2	1	1	0	1	0	1	2	0	2	12	2	5
OTHER TRAFFIC AND DMV HEARINGS	1	4	6	0	6	4	4	4	1	2	3	7	42	8	16
LANDLORD/TENANT	4	0	2	2	3	1	1	3	2	0	1	2	21	4	5
HOUSING	3	4	3	3	6	0	5	6	2	3	4	5	44	8	11
CRIMINAL/JUVENILE	0	2	1	2	0	0	2	1	1	3	0	2	14	2	5
PUBLIC BENEFITS	10	5	2	4	3	3	1	0	3	3	1	0	35	7	0
TAX	0	1	0	1	0	2	2	2	3	0	2	1	14	2	2
MISCELLANEOUS	1	1	3	1	0	3	3	3	3	4	3	2	27	5	5
TOTAL	40	47	50	40	46	50	59	42	41	44	32	45	536	100	
PREPARATION OF TAX RETURNS (different eligibility standards)	0	60	133	134									327		
GRAND TOTAL, 1981 CASES													863		

LEGAL SERVICES CORPORATION, 1981: TYPES AND HANDLING OF CLOSED CASES

The newly released 1981 Annual Report of the Legal Services Corporation is a half-hearted effort that reflects LSC's struggles of the past 18 months, but it does contain two charts that may be useful to legal plans. The first shows how closed cases were resolved, the second what those cases were about.

Of particular note in the first chart are the low percentage of cases resolved at the advice and referral level, and the low ratio of negotiated settlements to court and agency decisions. Numerous factors can be cited to account for these figures, but it is impossible without more information to weigh the factors. It would be very interesting to know what difference it makes that legal services attorneys generally do not need to consider fees in deciding how far to pursue a case or when to compromise.

The second chart reflects both the actual and perceived legal needs of eligible clients, *and* the priorities assigned those needs by legal services programs. Few programs are able to handle all the cases they're permitted to accept. Neither the chart nor the report tells us how much program priorities influence the breakdown of problems shown on the chart.

CLOSED CASES - HOW HANDLED

Advice	31.7	
Referred	7.7	
Brief services	14.4	
		53.8
Negotiated settlement without litigation	6.6	
Negotiated settlement with litigation	4.1	
Administrative agency decision	5.8	
Court decision	10.9	
		27.4
Client withdrew	11.4	
Insufficient merit	3.0	
Miscellaneous	4.4	
		18.8
TOTALS	100.0	100.0

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CLOSED CASES - BREAKDOWN OF PROBLEMS

TYPE OF PROBLEM	*%*	*%*
FAMILY		29.5
Divorce/Separation/Annulment	15.8	
Custody/Visitation	4.5	
Support	2.5	
Spouse Abuse	1.6	
Guardianship/Conservatorship	1.0	
Family Adoption	0.7	
Name Change	0.6	
Paternity	0.5	
Parental Rights Termination	0.2	
Other Family	2.0	
INCOME MAINTENANCE		18.0
AFDC/Other Welfare	4.7	
SSI	3.6	
Social Security	3.2	
Unemployment Compensation	3.0	
Food Stamps/Commodities	1.3	
Veterans Benefits	0.4	
Workers Compensation	0.3	
Black Lung	0.1	
Other Income Maintenance	1.4	
HOUSING		17.8
Landlord/Tenant	11.4	
Homeownership/Real Property	2.5	
Federal Housing	1.1	
Other Public Housing	0.9	
Other Housing	1.8	
CONSUMER FINANCE		13.7
Collection	4.6	
Bankruptcy/Debtor Relief	2.4	
Contracts/Warranties	1.8	
Public Utilities	1.6	
Loans/Installments/Purchases	0.4	
Unfair Sales Practices	0.3	
Energy	0.2	
Credit Access	0.1	
Other Consumer Finance	2.4	
EMPLOYMENT		2.9
Wage Claims	0.7	
Job Discrimination	0.6	
Other Employment	1.6	
INDIVIDUAL RIGHTS		2.8
Immigration/Naturalization	0.9	
Mental Health	0.6	
Prisoners Rights	0.6	
Physically Disabled Rights	0.1	
Other Individual Rights	0.6	
HEALTH		2.0
Medicaid	0.9	
Medicare	0.3	
Other Health	0.8	
JUVENILE		1.2
Neglected/Abused/Dependent	0.6	
Delinquent	0.2	
Other Juvenile	0.4	
EDUCATION		0.5
MISCELLANEOUS		11.6
Wills/Estates	2.5	
Torts	1.9	
License (Auto & Others)	0.6	
Indian/Tribal Law	0.2	
Incorporation/Dissolution	0.1	
Other Miscellaneous	6.3	
TOTALS	100.0	100.0

(continued next column)

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PLAN DATA:

NORTH CAROLINA PREPAID LEGAL SERVICES CORPORATION

BENEFITS (optional plan for state employees)

Your agency must be enrolled in the Plan before you can join. The cost for each employee enrolled will be $9.50 per month by September 1, 1983, and this is payroll deductible.

THE POLICY COVERAGE CONSISTS OF FOUR SECTIONS, WITH THE MAXIMUM YEARLY TOTAL AMOUNTS PAYABLE SHOWN:

ADVICE AND CONSULTATION	OFFICE WORK	JUDICIAL AND ADMINISTRATIVE	MAJOR LEGAL
~~$100~~	$350	$750	$2,000
4 per year @ $25	*Employee pays $25 deductible per year.*	*Employee pays $25 deductible per case if plaintiff; no deductible if defendant.*	*20%*

EXAMPLES

- advice	- letter writing:	$15	- divorce:	$150	- defense expenses in court above judicial and administrative section
- interviews	- real estate:	$150	- traffic:	$150	
- legal questions	- wills:	$50/75	- small claims:	$100	
	- wills & trusts:	$125/175	- shoplifting:	$150	
- consultation	- separation:	$100	- DUI:	$250	
	- domestic:	$150	- guardianship:	$150	
	- deeds:	$25			
	- name change:	$150			
	- bankruptcy:	$150			
NO DEDUCTIBLE					PLAN PAYS 80% EMPLOYEE PAYS THE BALANCE

Attorney fees are paid for other cases at $50 per hour.

MAXIMUM BENEFIT... $3,200 for each family per year.

Some legal expenses not covered under this plan include: 1) business pursuits; 2) filling out of tax forms; 3) contingency fee cases; and 4) legal services started while the employee was not covered under this plan.

Benefits are not available for real estate transactions and domestic relations cases during the first 180 days of continuous coverage. Some services have scheduled maximum amounts. Real estate transactions and domestic cases are limited to $150 each annually.

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ENROLLMENT AND CLAIMS BY TYPE OF GROUP
(May 1983)

CATEGORY	NO. EMPLOYEES	NO. ENROLLED	% ENROLLED	CUMULATIVE CLAIMS RATIO
All Cancelled Groups	0	0	-	115.0%
State Employees	51,535	818	1.6%	67.5%
Universities	24,815	741	3.0%	75.2%
Private Groups	1,495	317	21.2%	79.4%
TOTAL	77,545	1,876	2.4%	72.1%

CLAIMS SUMMARY
(May 1983)

	MONTH	CUMULATIVE
Premium (Income)	$16,675	$983,252
Claims Paid	$ 8,542	$705,090
Loss Ratio (%)	51	72
Enrollment	-3	1,877
Number of Claims	52	4,251
Percentage of Group	3	226

	ADVICE & CONSULTATION	OFFICE	JUDICIAL & ADMINISTRATION	MAJOR LEGAL
Type of Claim:	6	30	16	1

AVERAGE COST PER CLAIM:

$164

UTILIZATION CLAIM COST BY YEAR

	NO. CLAIMS	ANNUAL CLAIMS	AVERAGE COST PER CLAIM	NO. ENROLLED	UTILIZATION RATE
1977-78	669	$111,907	$167	1305	4.3%
1978-79	1234	180,459	146	1950	5.3%
1979-80	689	99,394	144	1518	3.8%
1980-81	605	96,967	160	1570	3.2%
1981-82	646	108,458	168	1884	2.9%
1982-83	658	128,585	195	1892	2.8%
	4501	$725,770	$159	1687	3.7%

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CASE DATA
(May 1983)

	LEGAL SERVICE	# CLAIMS	TOTAL COST	AVERAGE COST	% TOTAL
A & C:	Advice	6	$136	$ 23	1.59
OFFICE WORK:	Simple Will	5	275	55	3.22
	Will & Trust	7	1,069	153	12.51
	Trust				
	Guardianship				
	Separation	2	200	100	2.34
	Uncontested Divorce				
	Annulment				
	Adoption				
	Name Change				
	Letter				
	Negotiation	1	120	120	1.41
	Child Support	1	25	25	.29
	Pers. Bankruptcy	1	50	50	.59
	Domestic				
	Title Search	9	1,164	129	13.63
	Tax-Invest				
	Custody				
	Birth Certificate				
	Power of Attorney	2	64	32	.74
	Estate Planning	3	250	83	2.93
	Land Partition	1	150	150	1.76
	Easement	1	47	47	.54
	Landlord/Tenant	1	195	195	2.28
J & A:	Civil Suit	2	1,003	501	11.74
	Divorce	3	425	142	4.98
	Child Custody				
	Adoption				
	Alimony, Child	2	300	150	3.51
	Name Change				
	Bankruptcy	1	150	150	1.76
	DUI	2	400	200	4.68
	Other Traffic	2	300	150	3.51
	Drugs				
	Temp. Order				
	Bastardy	1	650	650	7.61
	Misdemeanor				
	Intoxication				
	Felony	2	1,325	663	15.51
	Vol. Dismiss				
	Criminal Assault				
	Breach of Contract	1	175	175	2.05
MAJOR LEGAL:		1	70	70	.82
TOTAL:		57	$8,542	$150	100%

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RESULTS OF NATIONAL EDUCATION ASS'N CLIENT SURVEY

This questionnaire was used to evaluate the NEA Attorney Referral Program in order to assess the services provided to NEA members through the program.

1. The label at the top of the questionnaire indicates whether NEA records classified the services you received as either an "advice only" case or a "fee generating" case. Please indicate which service you received. (Check ONE.)
   45.5% Advice only (no charge)
   54.5% Services at a Reduced Fee (paid a fee)

2. How did you find out about the NEA Attorney Referral Program? (Check ALL that apply.)
   38.4% Regular national or state association newsletter or publication
   46.7% Regular local association newsletter or publication
   26.0% Special brochure describing the program
   34.4% Personal contact with national, state, or local association leaders or staff (faculty representative, UniServ staff, etc.)
   26.9% Colleague
   4.8% Other (please specify) ______________

ADVICE ONLY - NO FEE

3. Regardless of whether or not your legal problem was resolved to your satisfaction, how would you rate the quality of the legal advice you received?
   62.3% Very good 34.1% Good 3.3% Poor .3% Very poor

4. On the basis of your personal experience with this attorney, how would you rate the attorney on each of the following characteristics? (Check ONE response per line.)

	Very good	Good	Poor	Very poor
Concern about your problem	59.4%	35.1%	4.6%	.9%
Ability to understand the nature of your problem	61.8%	33.2%	4.9%	-
Success in exploring a variety of solutions to your problem	48.6%	40.4%	9.5%	1.6%
Honesty in dealing with you	72.4%	24.8%	2.5%	.3%
Success in explaining matters fully to you	64.2%	30.7%	4.7%	.3%
Other (please specify) ______________	54.2%	8.3%	12.5%	25.0%

SERVICES FOR WHICH YOU PAID A FEE

5. Please rate the quality of the legal services received (regardless of outcome) and rate the outcome of your legal problem. (Check ONE response per line.)

	Very good	Good	Poor	Very poor
The quality of the legal services	65.6%	29.2%	3.6%	1.6%
The outcome of the legal problem	64.1%	31.6%	2.4%	1.8%

6. On the basis of your personal experience with this attorney, how would you rate the attorney on each of the following characteristics? (Check ONE response per line.)

	Very good	Good	Poor	Very poor
Concern about your problem	66.8%	28.6%	3.3%	1.3%
Ability to understand the nature of your problem	70.8%	24.9%	3.8%	.5%
Success in exploring a variety of solutions to your problem	61.2%	32.1%	5.4%	1.3%
Honesty in dealing with you	74.9%	20.9%	2.4%	1.8%
Success in explaining matters fully to you	69.7%	25.3%	3.7%	1.3%
Promptness in taking care of matters	63.8%	28.9%	3.4%	3.9%

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6. (continued)

	Very good	Good	Poor	Very poor
Success in keeping you informed of progress	57.8%	33.5%	5.7%	3.0%
Flexibility in making appointments at times convenient to you	76.3%	20.2%	1.9%	1.6%
Other (please specify) ____________________	68.8%	20.8%	6.3%	4.2%

7. Did the attorney provide an estimate of the total cost of the services to be provided?
   - 64.3% Yes, at the initiation of the services
   - 7.9% Yes, at some other time during the services
   - 11.5% Yes, at both the initiation and during the services
   - 16.3% No, no fees were discussed until the conclusion of the services

8. If an estimate was provided, how accurate was it?
   - 76.5% Very accurate
   - 20.7% Reasonably accurate
   - 2.7% Inaccurate -

9. Do you believe that the fees you were charged were fair, given the extent of the services provided?
   - 79.0% Yes
   - 8.4% No
   - 12.6% Don't know

10. Do you believe that the fees you were charged were lower than those you would have been charged by an attorney not in the program?
    - 64.7% Yes
    - 9.7% No
    - 25.7% Don't know

THIS SECTION SHOULD BE COMPLETED BY EVERYONE

11. Prior to consulting an attorney in the Attorney Referral Program, had you engaged an attorney on a legal matter in the last FIVE years?
    - 41.1% Yes
    - 58.9% No

    If Yes, for how many different legal matters had you engaged an attorney in the past FIVE years? (Do not count your experience under the Attorney Referral Program.)
    1-58.8% 2-24.6% 3-9.3% 4-3.5% 5-1.7% 6-1.0% 7-.3% 10-.3% 14-.3%

12. If the Attorney Referral Program had not been available to you, how would you have resolved your legal problem?
    - 69.8% Through another attorney in private practice
    - 7.2% Through another legal services program
    - 11.3% By myself, without an attorney
    - 9.2% I probably would not have taken any action
    - 2.6% Other (please specify)

13. To what extent was each of the following a factor in your decision to use a program lawyer?

	Major factor	Minor factor	Not a factor
Fees seemed to be the most reasonable available	72.7%	11.9%	15.3%
Only attorney to whom I had access	10.1%	14.7%	75.2%
Convenient office location	23.2%	30.8%	46.0%
Credit card or some other installment credit financing of fees was available	2.5%	4.3%	93.2%
I felt that NEA and state association sponsorship of the program would assure competent legal advice	77.2%	16.1%	6.7%
Other (please specify)	93.0%	-	7.0%

14. Would you consult this attorney in the future?
    - 53.3% Definitely would
    - 37.4% Probably would
    - 5.1% Probably would not
    - 4.2% Definitely would not

15. Regardless of your opinion of this attorney, how valuable do you think the Attorney Referral Program service is to NEA members?
    - 90.2% Very valuable
    - 7.7% Moderately valuable
    - 2.1% Slightly valuable
    - - Not valuable

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COST AND QUALITY:

AN OPERATIONAL PROGRAM FOR IDENTIFYING "OUTLIERS"

by Dennis Farnsworth and Bill Bolger

(*Editor's Note:* This article is adapted from Dennis Farnsworth's presentation at the API's Third Annual Educational Conference in Tampa, November 1983.)

A comprehensive quality control program for a legal services plan will have several components, both because the parties involved (client, lawyer, administrator) may have different views of "quality," and because the program may have different objectives. A client-focused objective would be "No Unhappy Clients" or a 100% renewal rate. The quality control program would need open communication lines to detect and resolve client dissatisfaction at an early stage. It would require a responsive grievance system. It would stress member education to prevent unreasonable expectations. And it would look for excellent "bedside manners" from its providers.

Provider-focused objectives might be a prestigious panel or high peer review ratings. The quality control program would emphasize the attorneys' qualifications and skills. An attorney rating system combining objective and subjective factors, such as that described in the Night Owl Legal Plan Attorney Merit Rating System*, would be important. Peer evaluation of client files, and attorney interviews and credentials would determine "quality."

An administrator-focused objective would be maximum service at minimum cost. One approach to this objective would: 1. determine the cost/quality tradeoff curve and the optimum point on it for the legal services plan, and then 2. seek ways to reach that point. This article describes one attempt at detecting and controlling extreme deviations from that point.

The literature on legal services plans contains very little on cost/quality tradeoffs, but there is more in the health care field. Conceptually, at least, it seems clear that increasing cost beyond a certain point will not further improve quality. Unnecessary tests or services might reduce quality. A Rand Corporation study** came up with the following sensible curve.

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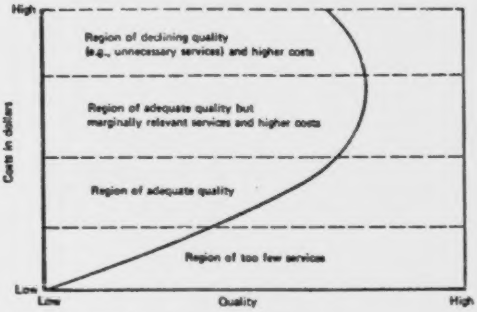
* by Dennis Farnsworth, available for $1 from the Resource Center

** Robert H. Brook, Allyson Ross Davies, Caren J. Kamberg, *Selected Reflections on Quality of Medical Care Evaluations in the 1980's*, Rand Note N-1308-HEW, December 1979.

CONCEPTUAL COST/QUALITY TRADE-OFF CURVE

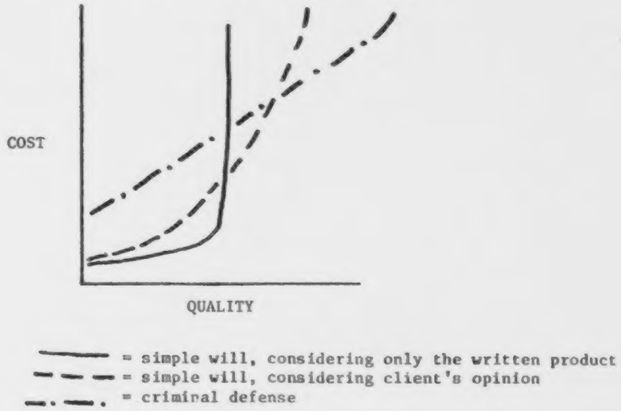


SOURCE: Adapted from Brook, Williams, and Avery (1976)

Conceptual cost/quality tradeoff curve

Sensible, that is, if we recognize its limits. The curve shows that paying more gets one more, up to a point. The curve can't really be used in any specific way. Not only will the curve have different shapes for different services, but it will vary depending how we define "quality" (e.g. Does the client's opinion about a result count, or just the result itself?).

HYPOTHETICAL COST/QUALITY CURVES



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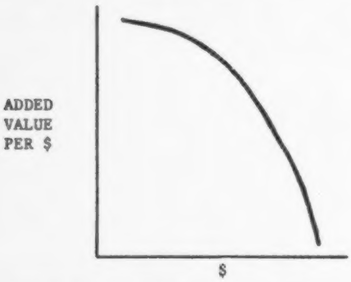
Even with a firm definition of quality and a good curve for a specific legal service, there remain important questions: where does the plan want to be on the curve? And how tightly should clients be restricted to one section of the curve? These are policy decisions. It is not clear that all plans should seek the utmost in quality, especially for routine services. Clients usually don't. Just as each additional dollar contributed to a legal plan buys less than the one before it, so (beyond a minimum threshold) does each additional dollar paid to a lawyer buy less additional value than the one before. Marginal utility declines for legal services as it does for most products and services.

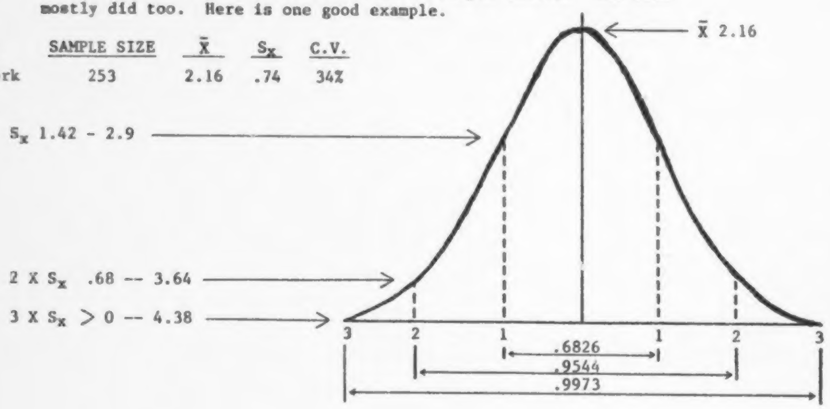
MARGINAL VALUE - CONTRIBUTION TO PLAN OR PAYMENT TO LAWYER



The question is how much marginal utility is the plan going to require from each increment it pays to providing lawyers.

Group Fifty started addressing this question formally for Michigan Education Association Legal Services (M.E.A.L.S.) in 1979. For a year and a half we simply collected and plotted data. The plan's modified open panel and Shreveport/hour bank fee structure imposed relatively few clear limits on attorney's billings for routine services. We knew from previous research and experience that fees for legal services follow a normal distribution (bell-shaped curve). The data mostly did too. Here is one good example.

CATEGORY	SAMPLE SIZE	$\bar{X}$	S_x	C.V.
Office Work	253	2.16	.74	34%



The average bill out of 253 bills received under the office work benefit category was 2.16 hours ($\bar{X}$). The standard deviation (S_x) was .74 hours. This is the variation from the average necessary to encompass 68% of all bills received. In other words, 68% of all office work bills were for between 1.42 and 2.9 hours. Over 95% of all bills were within 2 standard deviations of the mean, or between .68 and 3.64 hours.

While the data were being gathered we continued our established system of challenging approximately the top 10% of all bills. Some of the challenged bills involved extenuating circumstances, but most were adjusted in some way. About 4% required senior-level negotiation.

We combined our plotted data and our experience with challenged bills into a formula that has worked very successfully for over 2 years:

$$U.L. = \bar{X} + S_x + 2S_xE$$

where

U.L. is the upper limit
$\bar{X}$ is the average bill in a category
S_x is the standard deviation in that category
S_xE is the standard error in that category

Note that we have better data and tighter parameters on some categories (such as office work) than on others.

Any bill exceeding U.L. is an "outlier" and is automatically challenged. In fiscal year 1981 the formula required challenges of 7.9% of all bills, 42 cases in all. In fiscal '82 the figures were 8.5% and 58 cases. In both years between 3% and 3.5% of all bills turned out to be severely and/or unjustifiably out of line.

Many plans routinely challenge all bills that are clearly higher than normal. It doesn't require the kind of data plotting and statistical work we did to decide that this is a reasonable way to avoid overpaying. Nor is this method adequate by itself. It will not, for example, identify or help control "creeping averages," by which we mean the tendency for lawyers to bill the standard amount more routinely and to more often find reasons why a bill should exceed the average as time goes on. This requires spot checking of bills within the normal range.

Publishing data such as this can create its own problems, too. If lawyers know the limits they can increase their average bills without incurring scrutiny so long as none of the bills is an "outlier." So, a procedure for challenging all high bills is but one aspect of a cost control program, which is but one component of a complete quality control program, but it's a key one.

The whole method reminds us of what used to be a common method for setting speed limits. Speeds over the stretch of road would be monitored while it was unposted. The speed limit chosen would be that speed which 85% of all drivers stayed below, rounding to 5 m.p.h. increments. Crude in one sense, very shrewd in another.

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TECHNIQUES TO ENHANCE UTILIZATION

High utilization is usually considered one mark of a good plan. Many plan proponents regard preventive law and education as the most important function of a plan. Since the existence of a plan does not increase the incidence of major legal problems much at all, high utilization tends to correlate with more preventive law and education. Voluntary enrollment plans are finding that only members who use a plan will stick with it. Here are some frequently used techniques for increasing plan use.

PRESCHEDULED CHECKUPS. If a plan member has already met his lawyer before a question or problem arises he is more apt to contact him, and promptly, when something comes up. The prescheduled checkup is a good way to have lawyer and potential client meet. A new member can be sent a "welcome package" that includes a legal checkup form and a time, date and place for consultation. A negative checkoff system may be used under which the member need do nothing if the interview time is convenient and he intends to come. This system should get the highest turnout, but obviously there will be some people who don't show up.

One alternative is to provide several different times and request that the member call to say which would be most convenient. Another option is to have the plan office call the member to schedule the appointment; a third is to send reminder cards to members who haven't scheduled themselves. Many variations are possible. The problem is to decide how far to go in urging the client to come in.

Whatever method is chosen, the client will need to complete a legal checkup form of some sort, preferably at home in advance, otherwise at the office. The former has the advantages that a spouse can be consulted, papers found and the form completed without time pressure. The latter has the advantage that help in completing the form is readily available.

WILL REVIEWS. Since wills are by far the leading preventive law service, some plans use an estate checkup rather than a full-scale legal checkup as an introductory tool. All of the same scheduling options apply. People without wills usually feel a bit guilty about their situation, and will remedy it given the right opportunity.

NEWSLETTERS. These are not an adequate substitute for in-person or telephone meetings, but they can be a valuable tool for promoting and strengthening a plan. Their advantages and disadvantages are self-evident. They are most often used to remind members of their benefits, to discuss widely-shared legal questions, to promote new services, and to sound out opinion on issues of common concern. The two most common failings of such newsletters are too irreg-

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ular or infrequent publication, and too "fluffy" content. If a plan does not seriously intend to mail a newsletter at least quarterly, it should consider designing each communication as a "special bulletin" or the like.

Many plans, perhaps most, are sponsored by an organization that already has a newsletter or magazine. In these cases it usually makes more sense to run a regular column plus occasional news items or longer articles about the plan and about legal topics. Sponsoring groups should be eager to spread the word about their good works. Editors are always happy to receive relevant material. Extra printing and mailing costs are avoided. Readership is increased.

FOLLOW-UP LETTERS. Most plans have some sort of client evaluation form to be filled out by each client when his case is closed, but few have a regular system for contacting a member six months or a year after a case ends to see whether additional services are needed. Such follow-up is routine for internists, dentists and optometrists. Different time intervals may be appropriate after different types of cases. Follow-up on a will shouldn't occur for a year at least, whereas on a child support order three months may be more appropriate. For other cases an arbitrary period will have to be chosen. Remember that the rules against solicitation do not apply to plan members. Once a person joins a prepaid plan there is no rule against asking him to use it.

WORKSITE VISITS. Where a plan's membership is concentrated at one or a few workplaces, the simplest method of meeting members and reviewing needs is to have office hours at the workplace. Regular hours and a combination of scheduled appointments (by phone or sign-up sheet) and "open office" time make it very easy for members to visit. Temporary office space can often be arranged with the employer. If visits can be made on company time rather than at lunch, during breaks or after hours, so much the better. Workplace visits are, of course, relatively more important when the provider's offices are inconveniently located.

SEMINARS. These are a very commonly used education and promotion technique. The commonest mistake is overestimating the interest of the membership in attending. Such seminars are most successful in conjunction with another function or meeting. If given separately they *must* be scheduled at a convenient time or place. The workplace during the workday is best. Saturday morning at a downtown office building will be a disaster.

The second most common pitfall is going into too much detail and not putting the whole subject of discussion clearly into context.

EVENING HOURS. If members can not get paid time off for office visits, then it is imperative to have some evening or weekend appointments. Experience shows that most people prefer to make visits in the evening rather than on weekends, but each membership group is different.

A plan that uses none of the outreach techniques discussed above can hardly feel satisfied that it is fulfilling the preventive law function of a good plan.

SCREENING. To get utilization up, cut screening down. Screening by receptionists, secretaries and paralegals can annoy callers and visitors, waste time and cause misunderstandings. The tendency to evolve so as to suit the employees rather than the customers should be fought continually. Is this screener necessary? Is this form really needed?

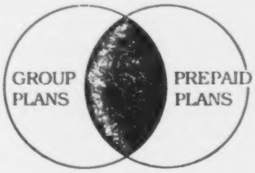
Chapter Two
An Overview of Cooperative Legal Service Plans

Plan Types: Definitions and Explanations

The diversity among the ten thousand or so legal service plans is considerable. Because plans may be characterized differently we will define our terms now, and endeavor to stick as closely to them as the facts of each plan allow.

Group v. Prepaid Plans. A *group* plan involves an arrangement between a group of people and a lawyer or lawyers. At bottom the term implies nothing else, but it is used generally to mean an arrangement in which there is no prepayment to the lawyer(s) by either the group or its individual members. In a typical group plan, a law firm makes fees or convenience (access) concessions to a group in expectation of increasing its volume of business by securing most of the members' legal business. In this manual, the term "group plan" means there is no prepayment for services.

For historical reasons having to do with bar associations' "ethical codes," most *prepaid* plans have involved, until very recently, as groups. Now, however, a few prepaid plans are being offered to individuals who share nothing but places on a mailing list or possession of a type of credit card. A prepaid plan involves some amount of advance payment to the legal service provider(s). Implied in the term "plan" is that the arrangement is offered in some way other than a traditional one-on-one contract between a lawyer and a client. The relationship between group plans and prepaid plans can be shown this way:



Automatic v. Voluntary Enrollment Plans. These terms refer to the enrollment basis of a plan. If everyone in the group is automatically a member of the legal plan by virtue of membership in the group, the plan is using automatic enrollment. Automatic enrollment plans may be group or prepaid. If prepaid, the member may pay through an earmarked portion of his dues, the group may pay a lump sum, or a third party may contribute on behalf of the group members.

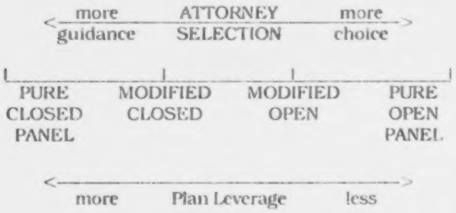
A voluntary plan requires each person or family to sign up (and pay money) in order to join the plan. Payment may be by various methods, including payroll deduction, share draft and dues checkoff. Voluntary plans are never able to offer the same benefits per dollar prepayment as otherwise equal automatic enrollment plans, for two reasons:

- –Voluntary plans have the additional expense of marketing their services to buyers; and
- –Voluntary plans must assume a higher rate of use, called adverse selection, since enrollees/buyers probably have a present need for services that persuaded them to enroll. That is, a voluntary plan must be marketed to each group member. Repeat solicitations are needed. Renewals must be sought. "Adverse selection" is insurance jargon meaning that the people most likely to use a plan are the ones who will sign up most readily.

Open v. Closed Panels. These terms refer to the degree to which a plan member's choice of attorney is restricted. In the early days of the legal services movement, whether to structure a plan as "open" or "closed" was a major, perhaps *the* major, battle between labor and consumer groups and the organized bar. Labor and consumers favored closed panels because of the leverage afforded the group in negotiating with the lawyer(s). Bar associations wanted to protect "freedom of choice" and to have all attorneys benefit from legal service plans. Today, the battle is over. Reason prevailed; today there are many open panel plans, many closed panel plans and even more that are somewhere in between.

The type of panel is often a matter of opinion. In a pure closed panel, members must use a single law firm or in house lawyers. More commonly there is a panel of lawyers who are spread throughout the geographical area where members live or work, such as city, county, a state or the whole country. How closed the plan is depends how far apart panel lawyers are and how far a member is willing to travel. The greater each panel lawyer's fees from the plan, the greater the plan's leverage in negotiating favorable terms with that lawyer.

In a pure open panel there really is no panel. The plan deals only with its members, who select their own lawyers as they would without a plan. Modified open panels are more common. These are open on equal terms to any lawyer who is interested, and any member may select any lawyer who has joined the panel. Open panels afford plan members a wider choice of attorneys, and are the only practical way to deliver services when the membership is thinly scattered. The panel spectrum can be illustrated like this:



Indemnity v. Service Plans. These are insurance terms that will have limited application to cooperative legal plans, but because we call one type of cooperative model (see Chapter 5) a service plan, it is necessary to mention the term in its other sense to avoid possible confusion for readers when dealing with insurance or health industry people. An indemnity plan is one where an insurance company promises to pay money reimbursements for services the policyholder has received. Under a service plan, the plan promises to provide stated services. Legal plans involving insurance companies can use either indemnity or service contracts in most states.

Other Terms. A plan *sponsor* is a group, such as a cooperative, that offers or endorses a plan for its members.

Provider is legal plan jargon for a lawyer or paralegal who provides legal services under a plan.

An *administrator* may be used to handle membership, plan enrollment, payments to providers, quality control, etc. A plan administrator could be an officer or employee of the co-op, an independent third party administrator or the law firm providing services.

Utilization rate is the number of cases or "matters" handled through a plan per year divided by the number of members in the plan, expressed as a percentage. This rate varies widely between plans, depending mostly on the structure of the plan, and partly on how "case" is defined by each plan and how membership is calculated. More will be said about this later.

Existing Plans

There are relatively few cooperative legal plans at present, but the ones that exist exhibit the same diversity as other legal plans, as the following brief sketches of a half dozen cooperative plans show.

1. **Consumers Group Legal Services, Inc.** (the Berkeley plan) is the oldest cooperative legal plan in the country. It is a separately incorporated combination prepaid plan and legal clinic associated with the 60,000 member *Berkeley Consumers Cooperative*. The 1,500 members of the plan pay a $9 one-time administration fee plus $30 a year, which entitles them to: two half-hour consultations with a staff attorney, reduced-fee referrals to a panel of 45 attorneys, access to a self-help plan for routine legal matters, monthly seminars and a newsletter (The education is serious—see their newsletter and notes on seminars). The plan has two full-time and two part-time staff attorneys plus a paralegal. The self-help plan provides the assistance of a paralegal, and costs a member only $75 for an uncontested divorce, $175 for a bankruptcy and $50 for an adoption. The plan advertises in the yellow pages and serves about 500 walk-in clients a year. Both walk-ins and members are entitled to services from the attorneys at competitive clinic rates.

   The plan presently has an operating budget of about $85,000 a year. It has been very marginal financially throughout its life, and only a suspension of services between 1976 and 1978, while memberships continued to be collected, enabled it to re-organize. It began with a $5,000 line of credit from the Berkeley Co-op and quickly enrolled 1,000 members. Renewal rates have never exceeded 45%. Marketing was restricted to the Co-op membership (by law) before late 1976, and since then the yellow pages advertising for walk-in business has given the plan the extra income it needed to survive. Extensive marketing has never taken place, however, and none is currently planned.

Mr. **Guarini**. I would like to call Steve Koplan, the legislative representative of the AFL/CIO and Alan V. Reuther, general counsel of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America, UAW, and Jack Curran of the Laborers International Union of North America, and Mike Tiner of the United Food and Commercial Workers International Union.

I welcome you gentlemen, and if you would proceed in the order of having been called. Mr. Koplan, will you kindly make your statement and your report will be put into the record.

STATEMENT OF STEPHEN KOPLAN, LEGISLATIVE REPRESENTATIVE, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. **Koplan**. Thank you, Mr. Chairman.

Before I give my statement, I would just like to take this opportunity to thank you and the other members of this committee for performing yesterday what we all consider a major legislative miracle in passing an excellent tax bill on the House floor. Our congratulations to all of you.

Mr. **Guarini**. I think the numbers surprised everybody. Thank you.

Mr. **Koplan**. But they were well deserved.

Mr. **Guarini**. Thank you.

Mr. **Koplan**. I will summarize my statement for the record, Mr. Chairman.

The AFL-CIO appreciates this opportunity to present its views in support of H.R. 5361, a bill that was introduced to extend for 5 years section 120 of the Internal Revenue Code and thus continue to encourage employers to provide group legal services plans for their employees.

We believe the current tax treatment of qualified group legal services plans has helped in encouraging the use and protections of such plans at minimal cost. There is no evidence that such plans have been abused, exploited as tax shelters, or led to inequities or discriminatory practices.

We urge that the committee act favorably upon H.R. 5361 and thus continue the current tax treatment of qualified group legal services plans.

We also recommend that the subcommittee give serious consideration to making section 120 permanent and thus end the uncertainty about their status.

Legal services plans exhibit considerable diversity in structure, cost, and benefits, depending on the group of people covered, their number, geographic distribution, family situation, et cetera, and the funding available.

Studies show that an average of 20 percent of covered employees in a group plan obtain legal assistance and for the most part they are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services.

This, of course, helps employees and assists in unblocking our overburdened judicial system. By making advance arrangements on a group basis, the time, cost, and uncertainty involved in selecting and consulting a lawyer when a legal question arises is dramatically reduced.

As a result, more people receive legal advice, matters are handled at lower cost and in a way that minimizes disputed litigation. The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine followup and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters, and so on, depending on the level of plan funding.

Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is frequently provided.

Although legal services plans fill a real and important need, their cost is modest. A plan that provides unlimited telephone advice and consultation with an attorney, some limited followup and reduced fees for additional services, costs between $15 and $60 per family per year. More comprehensive legal services plans cost between $70 and $250 per family per year.

In a 1979 study by the National Resource Center for consumers of legal services found the average cost of an employer-paid plan to be $87 per family per year. It is also unlikely that the cost of legal services plans will rise appreciably.

The average person does have real needs for legal services that now generally go unmet. But those needs can be satisfied inexpensively through group legal services plans. Such plans also help keep legal fees reasonable through the bargaining power of group plans.

Few sections of the Tax Code have so clearly achieved their objectives at such a low cost and with so little abuse. We believe that workers should not have to pay taxes on employers' contributions to qualified legal services plans.

I should like to close by noting that in 1979, the AFL–CIO Convention set forth general standards with respect to the taxation of fringe benefits. They included the following:

That provisions of present law which under specified conditions expressly grant tax exemptions for fringe benefits, including among others qualified pension plans, group life insurance, health benefits, and group legal services, should be continued.

We believe the present treatment of group legal services plans is consistent with those principles and should be continued.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF STEPHEN KOPLAN, LEGISLATIVE REPRESENTATIVE, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Chairman, the AFL–CIO appreciates this opportunity to present its views in support of H.R. 5361, a bill that you introduced to extend for five years Section 120 of the Internal Revenue Code and thus continue to encourage employers to provide group legal services for their employees. We believe that current tax treatment of qualified group legal services plans has helped in encouraging the use and protections of such plans at minimal cost. There is no evidence that such plans have been abused, exploited as tax shelters, or led to inequities or discriminatory practices.

Congress has acted three times in the past in support of group legal services plans. We urge that the Committee act favorably upon H.R. 5361 and thus continue the current tax treatment of qualified group legal services plans (Code Section 120). In 1973 Congress amended the Taft-Hartley Act to permit the use of employees benefit trusts to provide legal services. In 1976 Congress enacted section 120 for five years. In 1981 it was extended for three more years. We also recommended that the Subcommittee give serious consideration to making section 120 permanent and thus end the uncertainty about their status.

Under present law, amounts contributed by an employer to a qualified group legal services plan are excluded from an employee's income (or their spouses or dependents) for income tax purposes and from wages for employment tax purposes. In addition, organizations or trusts created exclusively to form part of a qualified plan are exempt from income tax. The exclusion for prepaid legal services and the tax exemption for group legal services organizations are scheduled to expire for taxable years beginning after December 31, 1984.

Legal services plans exhibit considerable diversity in structure, cost and benefits, depending on the group of people covered—their number, geographic distribution, family situation, etc.—and the funding available.

All plans help remedy the unmet legal services needs. Studies show that some 35 percent of the population each year encounter problems that could be solved by a lawyer but only 10 percent actually seek legal assistance. By contrast, an average of 20 percent of covered employees in a group plan obtain legal assistance and for the most part they are receiving preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. This of course helps employees and assists in unblocking our overburdened judicial system.

By making advance arrangements on a group basis, the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises is dramatically reduced. Thus, though these people covered by a plan tend to contact a lawyer more often, they do so at an earlier point in the course of a problem. As a result more people recieve legal advice, matters are handled at lower cost and in a way that minimizes disputed litigation.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on, depending on the level of plan funding. Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered than felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matters are covered. Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is also frequently provided. Although legal services plans fill a real and important need, their cost is modest.

A plan that provides unlimited telephone advice and consultation with an attorney, some limited follow-up and reduced fees for additional services costs between $15 and $60 per family per year. More comprehensive legal services plans cost between $70 and $250 per family per year and a 1979 study by the National Resource Center for Consumers of Legal Services found the average cost of an employer paid plan to be $87 per family per year. It is also unlikely that the cost of legal services plans will rise appreciably. The average person does have real needs for legal services that now generally go unmet—but those needs can be satisfied inexpensively through group legal services plans. Such plans also help keep legal fees reasonable through the bargaining power of group plans.

Health plans have only recently, through Preferred Providers Organizations (PPO's) and Health Maintenance Organizations (HMO's), begun to use their bargaining leverage with doctors and hospitals the way legal services plans have been bargaining with lawyers for over a decade.

The annual revenue loss associated with gualified group legal services plans is $25 million, according to the Joint Committee on Taxation and using the National Resource Center's average employer-paid plan cost of $87 per year and a 20 percent marginal rate of taxation, that amounts to $17.40 per covered family per year. In 1981 the UAW-Chrysler plan, then the second largest plan and the only truly nationwide prepaid plan, cost just under $30 per year. The cost of the Treasury was about $6 per family. Similarly, the huge new UAW-General Motors plan covering 1.4 million people is funded at just 3¢ per hour. That contribution of about $40 per employee per year covers families, retirees and their families, and recently laid off workers as well.

If section 120 is continued it is likely that the $25 million figure will grow as more people become covered. Nevertheless few sections of the tax code have so clearly achieved their objectives at such a low cost and with so little abuse. We believe that workers should not have to pay taxes on employers contributions to qualified legal services plans.

I should like to close by noting that in 1979 the AFL-CIO Convention set forth general standards with rspect to the taxation of fringe benefits. The Convention urged principles such as:

1. Sensible "de minimis" rules so that employers and employees need not take into account small benefit values which would cause unreasonable record keeping and administrative burdens.
2. Benefits that facilitate the employee's work performance, are provided for the convenience of the employer, or other support services, such as the furnishing of uniforms should not be taxed.
3. Limited benefits historically and broadly available such as discounts for employees or retail stores should be exempt from taxation.
4. Provisions of present law which under specified conditions expressly grant tax exemptions for fringe benefits including, among others, qualified pension plans, group life insurance, health benefits, and group legal services should be continued.

We believe the present treatment of group legal services plans is consistent with those principles and should be continued.

Mr. GUARINI. Thank you very much, Mr. Koplan.

Mr. Reuther.

STATEMENT OF ALAN V. REUTHER, ASSISTANT GENERAL COUNSEL, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, UAW

Mr. REUTHER. Mr. Chairman, my name is Alan Reuther. I am an assistant general counsel for the International Union, UAW.

The UAW would like to thank the committee for the opportunity to testify concerning the exclusion for group legal service plans. We commend the chairman for introducing legislation, H.R. 5361, which would help to assure the continued growth and development of group legal service plans by extending section 120 of the Internal Revenue Code for 5 years.

The UAW strongly supports this legislation and urges the members of this committee and the entire House to give it prompt favorable consideration.

At the same time, we hope this committee will give consideration to making section 120 permanent, which would finally resolve the uncertainty in this area.

UAW has long been a supporter of group legal service plans. In our view, they represent the best means of making quality, low-cost legal services available to average working men and women.

In 1977, the Chrysler employees, acting on the recommendation of the International Union, voted to use moneys which had accumulated in a special collectively bargained supplemental unemployment benefit reserve fund to establish and finance a group legal service program. This program, known as the UAW legal services plan, began operation in 1978 and has continued to provide legal services to Chrysler employees, retirees, and their families since that time.

The plan currently covers approximately 45,000 hourly employees, 50,000 retirees, and their families. The plan provides full legal services, including representation in litigation for consumer and debtor matters and real estate closings. Office work services such as consultation, drafting, research, are also provided for most other matters.

Since 1978, the Chrysler hourly program has handled about 90,000 cases. Approximately 25 percent of the workers have a case opened in any given year.

In the last set of negotiations with General Motors in 1982, the UAW was also successful in negotiating a group legal service plan covering GM employees, retirees, and their families. This program currently provides legal services to approximately 325,000 active employees, 180,000 retirees, and their families. The plan provides benefits similar to those provided under the Chrysler program. It is financed by current employer contributions amounting to 3 cents per straight time hour worked or about $48 per employee per year.

The GM program opened its doors in April 1983. We estimate that it will handle approximately 100,000 individual cases in the first year of its operations.

We have also negotiated group legal service plans for the Chrysler salaried and AMC employees, retirees, and their families.

In all, the UAW now has approximately 629,000 active employees, retirees, along with their families, covered under negotiated group legal services plans. We are pleased to report that the response of our membership to these programs has been enthusiastic. Utilization of the services provided by the plans has been high, and our members have also expressed satisfaction with the quality of the legal services provided by the program.

[The prepared statement follows:]

STATEMENT OF ALAN REUTHER, ASSISTANT GENERAL COUNSEL, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

Mr. Chairman, my name is Alan Reuther. I am an Assistant General Counsel for the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW). I speak on behalf of the more than one and one-half million active and retired members of the UAW and their families.

The UAW would like to thank the Committee for the opportunity to testify concerning the exclusion for group legal service plans. We commend the Chairman for introducing legislation (H.R. 5361), which would help assure the continued growth and development of group legal services plans by extending Section 120 of the Internal Revenue Service Code for five years. The UAW strongly supports this legislation, and urges the Members of this Committee and the entire House to give it prompt, favorable consideration. At the time, we hope this Committee will give consideration to making Section 120 permanent, which would finally resolve the uncertainty in this area.

The UAW has long been a supporter of group legal service plans. In our view, they represent the best means of making quality, low cost legal services available to average working men and women. Traditionally, legal services have been available in this country only to the top and bottom segments of society. The wealthy and powerful can afford to hire the best law firms. And the very poor are provided free representation through legal aid offices. Average middle class Americans have been left out in the cold. Too well off to qualify for legal aid programs, but with too little resources to be able to afford representation on their own, the average worker has simply gone without any legal services.

This situation began to change because of a number of developments in the late 1960s and 1970s. The Supreme Court struck down various restrictions on group legal practice. And the Taft-Hartley Act was amended to permit group legal service plans to be collectively bargained. Most importantly, Section 120 was added to the Internal Revenue Code in 1976, making it clear that employer contributions to and services provided under qualified group legal service plans do not constitute taxable income to employees.

As a result of these developments, labor unions increasingly began to take an interest in negotiating group legal service plans as a means of assuring that their members have access to quality, low cost legal representation. I am proud to say that the UAW has been in the foresight of this effort.

In 1977, the Chrysler employees, acting on the recommendation of the International Union, voted to use monies which had accumulated in a special collectively-bargained Supplemental Unemployment Benefit reserve fund to establish and finance a group legal service program. The plan currently covers approximately 45,000 hourly employees, 50,000 retirees, and their families. The plan provides full legal services, including representation in litigation, for consumer and debtor matters and real estate closings. Office work services, such as consultation, drafting, research, etc. are also provided for most other matters. Finally, with respect to noncovered matters, members can obtain referrals to private attorneys who have agreed to perform the services for reduced fees. Since 1978, the Chrysler hourly program has handled about 90,000 cases. Approximately 25% of the workers have a case opened in any given year.

In the last set of negotiations with General Motors in 1982, the UAW was also successful in negotiating a group legal service plan covering GM employees, retirees and their families. Known as the UAW-GM Legal Services Plan, this program currently provides legal services to approximately 325,000 active employees, 180,000 retirees, and their families. The plan provides benefits similar to those provided under the Chrysler program. Unlike the Chrysler program, however, the GM plan is financed by current employer contributions amounting to 3¢ per straight time hour worked (or about $48 per employee per year). The GM program opened its doors in April 1983; we estimate that it will handle approximately 100,000 individual cases in the first year of its operations.

The UAW has also negotiated group legal service plans for the Chrysler salaried and AMC employees, retirees and their families. These plans cover another 12,000 active employees and 10,000 retirees. They provide the same general package of benefits, and are financed by current employer contributions of 3¢ straight time hour worked and 2¢ per compensated hour respectively (about $50 and $36 per employee per year).

In all, the UAW now has approximately 629,000 active employees and retirees, along with their families, covered under negotiated group legal service plans. We are pleased to report that the response of our membership to these programs has been enthusiastic. Utilization of the services provided by the plans has been high. Furthermore, our members have expressed satisfaction with the quality of the legal services provided by the programs. Most importantly, our members have indicated that they consider group legal services to be an important and valuable fringe benefit which they are interested in preserving and expanding.

The types of legal problems handled by our group legal service plans break down as follows: 20 percent consumer, debtor matters; 25 percent family law matters; 20 percent real estate, housing matters; 20 percent wills, trusts, probate matters; and 15 percent all other matters (traffic, torts, criminal, administrative).

The consumer-debtor services have proven to be especially important for our membership, which has faced financial pressures as a result of lay-offs and the recession. The real estate and probate services have also proven to be valuable. By making these legal services readily accessible to our members, they have often been able to obtain legal advice before serious problems have arisen.

In order to keep the quality of legal services high while keeping costs low, the UAW has placed emphasis on the delivery of services through HMO type mechanisms. Where the concentration of employees is large enough in an area (usually about 2000 employees), offices have been established with salaried staff attorneys providing the legal services. In other areas where the concentration of employees is lower, we have contracted with private attorneys to provide the services under predetermined fee schedules for each benefit. Our experience with these delivery mechanisms, to date, has been extremely favorable, both in terms of keeping costs low, and in terms of the satisfaction of our members with the quality of the legal services.

The UAW remains committed to the growth and development of group legal service plans which can provide quality, low cost legal services to our members. In our view, the key to the continued growth and viability of group legal service plans is Section 120 of the Internal Revenue Code. Under that provision, group legal services are treated just like other major fringe benefits, such as employer provided health insurance. That is, employer contributions to pay for the cost of the fringe benefit, and the services or benefits provided under the program, are not considered to be taxable income to employees.

Section 120 is currently scheduled to expire on December 31, 1984. If it is not extended, the incentive for employers and unions to negotiate new group legal service plans will be seriously undermined. Worse, the continued operation of existing plans—including those now serving over 629,000 UAW members and their families—will be jeopardized.

In order to encourage the continued growth and development of group legal service plans, Congress should act promptly to extend Section 120. The UAW believes that the 5 year extension provided for under H.R. 5361 would be appropriate, since it would give employers and labor unions the assurance they need in the long term viability of group legal service plans in order to make a major commitment to such programs in collective bargaining. At the same time, we hope this Committee will give consideration to making Section 120 permanent, so as to eliminate any further uncertainty in this area.

Extending Section 120 will not cause any serious revenue loss for the federal government. The Joint Committee on Taxation has estimated that the tax expenditure associated with Section 120 amounted to only $20 million in 1982. Even assuming that the number and size of group legal service plans were to grow considerably in the future, because such plans are relatively inexpensive, the tax expenditure still would not be of sufficient magnitude to warrant concern.

In conclusion, the UAW would again like to commend you, Mr. Chairman, for your leadership in the promotion of group legal services. We wholeheartedly support the legislation which you have introduced (H.R. 5361) to extend Section 120 for 5 years. We believe passage of this important legislation will help to encourage the development of group legal services as a major fringe benefit, and to thereby make legal services available to millions of middle class Americans.

Mr. GUARINI. Thank you, Mr. Reuther.

Mr. Jack Curran of the Laborers' International Union of North America. We welcome you and appreciate your statement, sir.

STATEMENT OF JACK CURRAN, LEGISLATIVE DIRECTOR, LABORERS' INTERNATIONAL UNION OF NORTH AMERICA, AFL-CIO

Mr. CURRAN. Mr. Chairman, I am Jack Curran, legislative director of the Laborers' International Union of North America, AFL-CIO.

The Laborers International Union strongly supports legislation which will make permanent the exclusion contained in section 120 of the Internal Revenue Code for contributions by employers to group legal services plans.

The Laborers Union is uniquely qualified to testify on issues affecting group legal services plans because it pioneered in the development of these plans as a fringe benefit for workers. In 1971, the first major union legal services plan was established by Laborers Local 229 in Shreveport, LA.

This pilot, open panel plan, was established with the assistance and cooperation of the Shreveport Bar Association, the American Bar Association, and the Ford Foundation.

The following year, the first closed panel program, that of Laborers Local 423 in Columbus, OH, was established to serve as a mini law firm for the local's members. Staff attorneys were hired and salaried under the guidance of the local union. Funds to run the program were generated through an hourly dues check-off.

Then, in 1973, the legal services plan of the Laborers District Council of Washington, DC, was established to provide prepaid legal services to the 10,000 members and their families of eight laborers locals in the District of Columbia area. About 80 to 85 percent of the members lived in the Washington Metropolitan area, with the remainder living miles away in the rural areas of Virginia and Maryland.

This plan combined staff and open panel delivery systems with a heavy emphasis on the former. Approximately 85 percent of cases were handled by a team of staff lawyers located in the Washington offices. The remainder of the cases in the rural areas were handled by lawyers chosen by the members, often with the referral from the plan staff lawyers.

In 1972, Laborers Local 423 legal services plan of Columbus, OH, was established. The Laborers Local 423 plan distinguished itself on a number of grounds, notably its broad utilization and unusually wide variety of covered cases.

The most unique element of the Ohio program, however, was its cosponsorship of a clinical program with the Ohio State University College of Law, with partial funding from the Ford Foundation funded Council on Legal Education for Professional Responsibility. The program provided many types of services, including the capacity for preventive law; a capacity for comprehensive services, and most significantly, the ability not just to deliver legal services but to deliver quality legal services.

Because of our positive experiences with these plans, the Laborers International Union led the effort on the Taft-Hartley Act amendments in 1973 and, in 1976 we once again led the effort to enact section 120. The Laborers International Union remains as firmly committed now to group legal services plans as it was in 1973 and in 1976.

In little more than 10 years, group legal services plans have grown from a novel concept to an accepted reality endorsed by the labor movement, the organized bar, and the U.S. Government. It has enjoyed a growth rate that would be the envy of most modern social and political movements. It has produced a success rate in legal representation that is the envy of many private law firms. And, most importantly, it has begun to provide the vast body of middle-income working Americans with greater access to their courts, a fuller measure of justice, and the ability to better defend their rights and property. Until recently, those were privileges available only to the very rich. As a result of the group legal services movement, an opportunity to correct this longstanding imbalance has been realized.

Many unions have seized the opportunity to provide access to the justice system by establishing legal service programs for their members and families. They have done so because the programs are a logical addition to other vital fringe benefits already enjoyed by many union members. They ensure that members who need a lawyer can get one immediately. They maintain a high quality of legal representation. They provide legal services quite inexpensively compared to other methods of legal representation. They provide the convenience required by workers, including accessible offices, sometimes right in the union hall, and they often offer preventive law as a key element of the program.

It is no surprise that many unions and the workers they represent have come to regard group legal services as the most significant fringe benefit since the advent of prepaid health services.

For all of these reasons, it is critically important for the continued health and vitality of the group legal services movement that the section 120 exclusion be made permanent. A permanent exclusion will mean that these plans are treated fairly and equally alongside other fringe benefits under the Internal Revenue Code. Therefore, we strongly urge the Congress to enact legislation which will make section 120 a permanent part of the Internal Revenue Code.

With your permission, Mr. Chairman, I would like to present for the record a statement on behalf of Robert Georgine, president of the Building & Construction Trades Department, AFL-CIO.

Mr. GUARINI. It will be so placed in the record, Mr. Curran. Thank you very, very much.

[The statement appears on p. 334.]

Mr. GUARINI. Mr. Mike Tiner of the United Food and Commercial Workers International Union. Welcome, sir.

STATEMENT OF MICHAEL L. TINER, ASSISTANT DIRECTOR OF GOVERNMENT AFFAIRS, UNITED FOOD & COMMERCIAL WORKERS INTERNATIONAL UNION, AFL-CIO

Mr. TINER. Thank you, Mr. Chairman.

My name is Mike Tiner. I am the Assistant Director of Government Affairs for the United Food & Commercial Workers International Union.

The UFCW appreciates this opportunity to present its views on H.R. 5361. The UFCW believes that the current tax treatment of qualified group legal services has helped in encouraging the use and protection of these plans at minimal cost. Accordingly, the UFCW supports the chairman's legislation, H.R. 5361, to extend for 5 years the current tax treatment of qualified legal service plans.

We would, however, urge the subcommittee to investigate the possibility of making the current tax treatment permanent. Making permanent section 120 would remove any existing uncertainty about the status of these worthwhile programs.

We were unable to determine the total number of UFCW locals currently providing group legal service benefits to their members. However, we have identified three UFCW locals that provide this benefit. Let me just highlight one.

In the Metropolitan Washington, DC, area, UFCW Local 400 has a legal service plan that provides free legal services to approximately 18,000 employees, of two area retail chains and their families. An additional 10,000 members and their families who are not employed by these chains qualify for reduced cost legal services by virtue of their membership in local 400.

In closing, let me reemphasize that although we support H.R. 5361, we would strongly urge the subcommittee to consider making the income exclusion of section 120 permanent.

Thank you.

[The prepared statement follows:]

STATEMENT OF MICHAEL L. TINER, ASSISTANT DIRECTOR OF GOVERNMENT AFFAIRS, UNITED FOOD & COMMERCIAL WORKERS INTERNATIONAL UNION (AFL-CIO)

My name is Michael L. Tiner. I am Assistant Director of Government Affairs of the United Food and Commercial Workers International Union (AFL-CIO).

The UFCW is a labor union with 1.3 million members organized in some 600 local unions throughout the United States and Canada. The UFCW and its local unions have collective bargaining agreements with tens of thousands of employers throughout the food processing, retail sales, fur, leather, health, commercial, shoe and other industries.

Mr. Chairman and Members of the Subcommittee, the UFCW appreciates this opportunity to present its views on H.R. 5361, an act extending for five years Section 120 of the Internal Revenue Code—the income exclusion for group legal service plans.

Since Congress amended the Taft-Hartley Act in 1973 to permit the use of employee benefit trusts to provide legal services, it has acted twice to extend the income exclusion. In 1976, Congress extended Section 120 for five years, and in 1981, it was extended for three years. The UFCW believes that the current tax treatment of qualified group legal services has helped in encouraging the use and protections of these plans at minimal costs.

Accordingly, the UFCW supports the Chairman's legislation, H.R. 5361 to extend for five years the current tax treatment of qualified legal service plans. We would, however, urge the Subcommittee to investigate the possibility of making the current tax treatment permanent. Making permanent Section 120 would remove any existing uncertainty about the status of these worthwhile programs.

Although legal service plans exhibit considerable diversity in structure, cost and benefits, all plans help remedy the unmet legal service needs. Recent studies show that some 35 percent of the population encounters some problems that could be solved by a lawyer, but only 10 percent actually seek legal assistance. By contrast, an average of 20 percent of covered employees in a group plan obtain legal assistance. It is important to point out that for the most part these covered employees are receiving preventive legal services and often make it possible to avoid litigation or protracted remedial services.

We were unable to determine the total number of UFCW locals currently providing group legal service benefits to members. However, we have identified three UFCW locals that provide this benefit.

1. In the Paterson, New Jersey area, UFCW Local 464A provides free group legal services for approximately 6,500 UFCW members. As the result of recent negotiations, an additional 3,000 members will begin receiving group legal service benefits on August 1, 1984. Local 464A was the first New Jersey local to negotiate group legal services having negotiated this benefit for its members in 1976.
2. In the Detroit metropolitan area, UFCW local 876's group legal service plan provides free legal services to approximately 14,000 of its members.
3. In the metropolitan Washington, D.C. area, UFCW Local 400 has a legal service plan that provides free legal services to approximately 18,000 employees of two area retail chains and their families. An additional 10,000 members and their families, who are not employed by these two chains, qualify for reduced cost legal services by virtue of their membership in Local 400.

By making advance arrangements on a group basis, the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises is dramatically reduced. Thus, though these people covered by a plan tend to contact a lawyer more often, they do so at an earlier point in the course of a problem. As a result, more people receive legal advice, matters are handled at lower cost and, in a way, that minimizes disputed litigation.

The legal services provided by plans are those most often needed by average citizens, starting with initial legal consultations, advice and routine follow-up, and continuing through routine matters such as wills, divorces, real estate transactions, consumer matters and so on, depending on the level of plan funding. Most plans attempt to provide reasonably generous benefits in case the individual is sued in civil court. Some plans provide some coverage in criminal cases. Traffic and misdemeanor matters are more often covered than felonies. Sometimes only the emergency stages (arraignment and bail) of criminal matters are covered. Plans generally tend not to cover matters subject to contingency arrangements, such as personal injury and probate cases. Some plans cover court costs and other litigation expenses. Almost all plans cover both the employee and his family. Coverage for retirees is also frequently provided. Although legal service plans fill a real and important need, their cost is modest.

According to the Joint Committee on Taxation, the annual revenue loss associated with qualified group legal service plans is $25 million. It is likely that if Section 120 were made permanent, the figure would grow as more people are covered. Nevertheless few sections of the tax code have so clearly achieved their objective at such a low cost. We believe that workers should not have to pay taxes on employers' contributions to qualified legal service plans.

The average person does have a real need for legal services that now often goes unmet. These needs can be satisfied inexpensively through group legal service plans. These group legal service plans also help keep legal fees reasonable through the bargaining power of group plans.

In closing, let me reemphasize that although we support H.R. 5361, we would strongly urge the Subcommittee to consider making the income exclusion of Section 120 permanent.

Mr. GUARINI. Thank you very much, gentlemen.

Is there a great demand among union members for such legal services as part of their fringe benefits?

Mr. KOPLAN. Yes, I would say that is the case, Mr. Chairman. I think this morning it was unfortunate for us to listen to the Treasury Department oppose the continuation of these plans when we have all waited now since 1976 for a study that was mandated at that time and was supposed to have been completed by the end of 1980. At the least, I would think, that absent having done that study, the Treasury would have come in this morning with no position on the legislation.

We all feel—if you would take our recommendation—that you should actually make these permanent to remove the uncertainty in terms of what will happen with the future of these plans.

But I think as the witnesses, as we all testified to today, the major benefit of these plans is that it is preventive and that much of the service that is provided is preventive service and saves court costs, and saves a person from protracted litigation.

So, it is preproblem planning that is taken care of.

Mr. GUARINI. As I understand it from your statistics, the average cost per family is less when you are in a plan than for people who are not in plans; is that correct?

Mr. KOPLAN. Yes; very, very modest. I think we all had figures in our testimony.

Mr. GUARINI. Now, is there any experience as to whether or not people who are in plans tend to use legal service and have more access to the judicial system than people who are not in plans?

Mr. KOPLAN. I would say that at the planning level, at the preproblem level, you would find that people would take better advantage. I think we talked in our testimony about telephone consultation, for example. People who do not have these plans—and I know you are an attorney as well, Mr. Guarini—people tend to wait until the problem is upon them before they seek the services of a lawyer.

Under these plans, the hope is that people would be educated to the fact that they can inquire of an attorney before they find themselves in litigation and tied to expensive and protracted law suits.

Mr. GUARINI. But when people have these plans, are there any statistics that show that they may use the plans more than, or abuse the use of the plans as compared to using attorneys in private practice?

In other words, is there any abuse of the plans by the people in the unions because a man can change his will every day if he wants to.

Mr. KOPLAN. Mr. Curran wants to address that. I was just going to say that in our testimony we indicated there has never been any evidence of any abuse of these plans. But I think Jack would like to address that as well.

Mr. CURRAN. I do not think there is any evidence of abuse. And in response to your original question, Congressman, we found that our workers did not use any legal services because they were afraid to call a lawyer. They were in doubt as to how much it was going to cost them and they just let the problems simmer and they got worse as time went on.

So, in order to make them a better worker, to relieve this mental problem that they had of whether they should go to a lawyer or not, we instituted the programs as I have outlined in my testimony, Group Legal Services.

We found that many of the problems that they were afraid of before were now solved legally. So, yes, there is a greater use of legal services now on the prepaid legal services plans than there was use of legal services before the legal services plans were established.

Mr. REUTHER. I would like to second what Mr. Curran has said. Our experience in the UAW is that our members have had much better access to legal services under the plans. That before, they were reluctant to consult an attorney. Now, they are much more willing to do so.

But we have not had problems with so-called chronic litigators or someone changing their will every day.

Mr. GUARINI. But it gave them a better feel for our legal system, apparently. They developed more confidence in the law, in the courts, in the lawyers as a result of having better access.

Mr. REUTHER. I think they are more willing to go see an attorney than they were before.

Mr. GUARINI. I am just curious, some plans have closed panels of attorneys; is that correct? You have to have an approved attorney that you go to. Is there a trend toward opening up the plans to the general bar or is there a trend toward a closed group of attorneys who would be the beneficiaries of a plan?

Mr. CURRAN. It depends upon the circumstances, Congressman. For example, in our Washington, DC, area we have people who live in the area and people who live outside the area. It is easy for the local people to go to the staff of attorneys that we have here in Washington, but for the outlying areas, we usually allow them to select their own attorney or take the advice of the lawyers that we have on staff who would recommend a lawyer in the outside area.

So, it all depends upon the circumstances.

Mr. GUARINI. But if they are here in Washington, they must use the attorneys that you have approved of; is that correct?

Mr. CURRAN. No; well, what they must do is go to the legal services plan office.

Mr. GUARINI. They have their choice.

Mr. CURRAN. That is right. First they go and report their problem to the attorneys here in town. The attorneys will advise them and tell them their options. They can use the staff attorney or select their own subject to coverage limitations. If you happen to live in Richmond, VA, you can get a lawyer in Richmond if you live that far away.

Mr. GUARINI. The only thing I am asking, Jack, is there a trend toward opening up these plans for participation by the general bar association, or is the trend more toward closed panels of attorneys selected for the working person?

Mr. CURRAN. I do not know what the trend is, Congressman. You have heard testimony from the insurance company representative. Some plans buy insurance and they figure that is the best way of handling it. It is a matter of choice.

Mr. GUARINI. Right.

Mr. CURRAN. The choice is made by the trustees of the plan.

Mr. GUARINI. Yes.

Mr. REUTHER. If I might respond.

Mr. GUARINI. Mr. Duncan?

Mr. DUNCAN. Thank you, Mr. Chairman. I apologize for being late, I had another commitment.

I think the time has arrived for some type of prepaid insurance, particularly for lower income people, middle and lower income people.

May I ask you, Mr. Curran, your plan, is it a nonprofit plan?

Mr. CURRAN. A nonprofit plan?

Mr. DUNCAN. Yes, sir.

Mr. CURRAN. All our plans are financed by a contribution somewhere in the area of 2 cents per hour to 3 cents per hour, depending upon the kinds of plans that we use. They are nonprofit plans. The money is used for the services.

Mr. DUNCAN. Strictly for the legal services.

Mr. CURRAN. Strictly for the legal service.

Mr. DUNCAN. You gentlemen certainly can be of great help in helping write this legislation. I want to thank you for being here.

Mr. KOPLAN. Thank you, Mr. Duncan.

Chairman STARK. I want to thank the panel. With the exception of Mr. Tiner, I have had the privilege of speaking with the other three members about their testimony prior and I was called away for another meeting for a minute. But I appreciate your taking the time to be here, and I hope that we can find a satisfactory solution to this extension in the weeks ahead.

Thank you very much.

Mr. REUTHER. Mr. Chairman?

Chairman STARK. Mr. Reuther?

Mr. REUTHER. If I could, I would like to respond to a question that Mr. Guarini raised about closed panel type plans versus open panel.

Chairman STARK. Certainly.

Mr. REUTHER. I think there is a wide variety in the types of approaches that plans use. Section 120 is neutral, you are free to establish whatever type of plan you want.

In the UAW, we favor the closed panel or staff type approach because we believe it can provide a better quality and a lower cost legal service. But I think right now what is needed is experimentation to see what the track record is. As I said, section 120 is neutral as far as that is concerned.

Mr. GUARINI. Well, has experience found that it is cheaper not to have the insurance company do it because you are just cutting out the middleman? Is the insurance company a middleman that really does not have to be involved in this, because you can have direct contracts with law firms?

Mr. REUTHER. In our major plans with General Motors and Chrysler, there is a trust fund with a board of directors and they either set up a staff of attorneys who are hired directly by the plan to provide the services, or they contract directly with attorneys, as you suggested.

In some areas where the concentration of members is not high enough, we have used an insurance company as an intermediary. But we prefer the other approach.

Mr. **Guarini**. But there are fewer plans handled through insurance companies, and there are more of the other direct contracts.

Mr. **Reuther**. I am not sure overall what the numbers would be, but our experience has been not to go through insurance companies.

Chairman **Stark**. Thank you, gentlemen.

Our next panel consists of Mr. Robert Winter of Arnold & Porter; Mr. Ernest Christian of Patton, Boggs & Blow; Mr. Donald Moorehead of Patton, Boggs & Blow, and Mr. Profusek of Jones, Day, Reavis & Pogue.

Gentlemen, I appreciate your taking the time and trouble to come and testify on H.R. 4357. I would like to state at the outset that your statements will appear in the record in their entirety.

I am sure you were here earlier to hear the Treasury suggest that this is a matter more properly brought before the SEC, and I am not sure the Chair would disagree with that. However, I am sure that I have seen you all here before on matters before this committee where we find that sometimes it is more expeditious to get socially desirable objectives accomplished through the Tax Code than it is through other, sometimes more cumbersome, legislative processes.

To the extent that you could, in addition to your written testimony, point out both the problems that this would—and I think it is in the nature of shareholder equity and reasonableness of compensation that we have an interest here on this committee—to the extent that this legislation would be harmful to reasonable corporate purposes, I would certainly like you to address yourselves to that.

To the extent that the same objective of not creating what the Chair feels is perhaps the wrong incentive for chief executives who somehow, it seems to me, should have a strong incentive to protect all shareholders to get equal treatment.

I have been aware of golden parachute plans where the amounts paid may not affect the average shareholder greatly relative to the total holdings of the company but it obviously would direct the incentives in a way that would seem to be in opposition to the shareholder.

But having said that, I would call on you in the order you appear and ask you to summarize or expand on your prepared statements in any manner you see fit.

Mr. Winter.

STATEMENT OF ROBERT H. WINTER, ESQ., ARNOLD & PORTER, WASHINGTON, DC

Mr. **Winter**. Thank you, Mr. Chairman.

I would like to emphasize precisely the questions you asked us to focus on, and that is, what are the problems that might be created by the proposed legislation.

Let me say first, however, that "golden parachutes" has become a pejorative term that has been used for a very wide variety of arrangements. Some, the ones that I believe have received the greatest attention, are those that have been entered into when a company is faced with a specific takeover and it is almost a tactical device to try to preclude the acquiring company from taking control.

On the other hand, there are numerous arrangements that I believe come within the scope of the current proposed legislation that have been adopted well in advance of proposed takeovers or threatened takeovers. Indeed, in some instances that were submitted and approved by shareholders and these, I believe, are designed to achieve quite legitimate corporate objectives.

In today's world, more and more companies are now the potential subjects of takeovers. There are very few companies, indeed, that are truly immune. For many companies, when an executive comes aboard, he is looking to have his legitimate expectations fulfilled. In large measure that depends upon him being able to complete the term of his employment as provided in an employment arrangement.

When you get involved with takeovers, as a starting proposition it is typically the case that the new owner wants to replace a certain number of executives, If they are bound by current form of contracts that are typically enacted, the executive can really be put in an impossible situation—comparable to a Government employee who has been a whistle blower finds his job description changed and the like.

At the present time—and now I will turn to the abuses that I see or the problems created by this—at the present time, it is typical for most corporations to have backloaded compensation arrangements. Typically, the rights to stock options are vested over time; salaries increase; benefits go up.

That assumes that the executive is going to be able to fulfill his period of employment. I believe if the current legislation goes through, what you are going to see is a change in that. You are going to see people go to companies likely to be takeover targets seeking to have much more of those compensation arrangements fixed in advance and immutable, so that they do not become subject to change and control terminations but nevertheless protect the executive.

I think this is likely to happen both in terms of immediate vesting of stock options, higher salaries initially; indeed even signing bonuses comparable to what you see in the sports world, which has been a rare instance in the corporate context. But this type of legislation would tend to encourage that, I believe.

Mr. STARK. Do you suppose that would extend to law firms, too?

Mr. WINTER. We are getting in that area, yes, Mr. Chairman.

I think you will also see an increasing rigidity in the drafting of employment contracts because the executive will have more and more concern that, notwithstanding an employment contract, a new owner, somebody he did not come to work for, is going to make his employment arrangement different from what it was. So that although it will not be called a change in control contract, it will allow the executive much more readily to declare a breach and become entitled in all circumstances to much larger levels of compensation.

I do not believe that is in the interest of shareholders, either.

Moreover, I think there are preferable ways in dealing with this, leaving aside the philosophical question of whether it is better in the Tax Code or as a matter of securities legislation.

First, this has been traditionally an area handled by State law. The problem is a very, very recent one in terms of truly abusive arrangements that, I think, most people would say are troublesome at the least.

There are a number of cases now pending before State courts which challenge these arrangements on traditional grounds. Moreover, I think a remedy that would eliminate the vast majority of abuses would be to require shareholder approval for changing control termination arrangements. Typically that is what you do with certain types of stock options, if there are going to be special benefits for it. As a practical matter, given the pressures of takeovers, if you require shareholder approval it precludes their use as a real tactical device and, frankly, if with fair securities law disclosure the matter is approved by shareholders, I do not see what the Federal interest is in taxing it.

Moreover, I would submit to you that often these sorts of provisions, particularly the type of provision that the Senate bill contains, have very unintended consequences. I could foresee a 200-percent standard almost becoming the norm if that is provided in the Tax Code, while today these are matters left to boards of directors who, in fact, generally act to protect their shareholders.

[The prepared statement follows:]

STATEMENT OF ROBERT H. WINTER, ESQ., ARNOLD & PORTER, WASHINGTON, DC

SUMMARY STATEMENT

Management compensation agreements play an important role in enabling companies to obtain competent managers. In recent years, there have been abuses, so-called "golden parachute" arrangements that have been entered into for what appear to be excessive amounts, often in contemplation of a takeover battle. The issue presented is: what is an effective remedy? Inappropriate compensation arrangements may well be in violation of state law and litigation is now pending. The Securities and Exchange Commission has expressed its concern with the adoption of arrangements in the face of a takeover but has suggested that those arrangements be distinguished from others. My own view is that there are remedies preferable to addressing the problem through tax legislation that is not designed to raise revenue and must inevitably take a very broad approach. A remedy that is too intrusive in decisions that should be left to boards of directors within ordinary businesses limits can have serious unintended effects. Troubled companies often have to offer substantial inducements to obtain competent management, including protection in the event of a changing control. To penalize arrangements that protect against a change in control may simply result in "front-loaded" contracts that are not in the interests of shareholders. There appears to be no basis for penalizing any arrangements if approved by the stockholders after fair disclosure.

STATEMENT

My name is Robert H. Winter. I am a partner in the law firm of Arnold & Porter, here in Washington. I have been interested for some time in matters of corporate takeovers and in questions of employment compensation. I have recently co-authored a book dealing with so-called "golden parachute" agreements, and have had occasion to review numerous examples of these types of contracts. I believe the issues addressed by H.R. 4357 are important, and I welcome the opportunity to present my views.

In recent months, much attention has focused upon takeover practices. The SEC's Advisory Committee on Tender Offers, which made an intensive study of the tender offer phenomenon, made a number of suggestions to curb perceived abuses, and the Commission has now made public its response to the Committee's recommendations. Issues relating to tender offers, and perceived excesses of behavior on the part of management of target companies in this context, have been widely debated in the press. I would like to address only one aspect of the matter: Whether there is a need for legislation to deal with the sorts of arrangements referred to in H.R. 4357 as "management protection agreements," and, if so, what form that legislation should take.

I start with the basic proposition that a company's ability to obtain competent management is critical to its success, and competent management requires fair compensation. Compensation of senior executives can take many forms including salary, bonuses, stock options, deferred compensation, retirement programs, and the like. In recent years, as mergers and hostile takeovers have become more common, and as even corporate giants have realized that they are not immune, a number of companies have reviewed these management contracts in the light of the legitimate expectations of executives to be protected from some of the consequences of hostile takeovers: A number of companies have recognized the need to establish a mechanism for preserving incentive benefits, many of which are tied to performance in a given year but which do not vest until many years later. Companies have also felt the need to put their executives in a position to evaluate objectively an offer which may lead to the termination of this employment. These companies have devised arrangements in order to preserve and vest the benefits existing at the time of termination upon a change in control and to provide a termination bonus to executives.

In many instances, the compensation the executive received after the change in control has not exceeded what the executive would have obtained had he been permitted to fulfill his legitimate expectations. In other cases, the levels of compensation have appeared to many to be excessive in terms of the prevailing salary levels of comparable employees in the industry or in terms of the net worth or earnings prospects of the employer-company. Indeed, in some instances, there is a perception that the arrangements have been entered into as part of a "scorched earth" policy that will substantially diminish the value, and therefore the attractiveness, of the employer-company to a corporate raider.

Practices vary concerning the adoption of these contracts. In some instances, they have been approved by boards of directors, including a majority of directors independent of management. In others, they have been submitted to shareholders and approved after fair disclosure, although applicable state law does not typically require such approval. Some contracts have been entered into in the ordinary course of business, at a time when the board is not confronted by a takeover threat. Other contracts for special compensation have been entered into only after a takeover threat is perceived. In effect, the contract may become one more tactic in the takeover battle. What is clear is that there are numerous types of employment arrangements entered into in a variety of circumstances. And, as the Commission has recognized, there are substantial problems in separating so-called "golden parachutes"—used as a pejorative term—from ordinary, regular course of business employment agreements.

In my opinion, the levels of compensation awarded in some instances have been excessive, and the circumstances suggest that the contracts are awarded out of self-interest. A number of lawsuits are presently pending challenging some contracts under various corporate law theories. The SEC's Advisory Committee concluded that compensation abuses may so undermine the public's confidence in the integrity of the takeover process as to require a federal response. While the SEC concurred, it emphasized the importance of distinguishing abusive arrangements from ordinary contracts. The Advisory Committee suggested that companies not adopt contracts with change of control compensation once a tender offer has commenced, and that other change in control compensation contracts be submitted to shareholders for an advisory vote. The SEC suggested no specific remedy.

The issue presented is: What is an appropriate remedy?

It warrants emphasis that there are legitimate needs addressed by special compensation arrangements in the event of a change of control. The colorful and pejorative "golden parachute" language used in the takeover arena should not obscure the fact that for many companies, these arrangements have proved necessary to obtain or retain the best available executive and to ensure their independence.

Mature, established companies may have little trouble attracting or retaining executives. In the case of many others, there are substantial risks as well as rewards in accepting employment. To cite but two examples: A troubled company trying to attract a senior manager from an industry leader does not have an easy time. Typically, a major concern of the executive asked to leave an attractive position is the security that he will have in his new employment. A term employment contract does not solve the problem. As a practical matter, even if the contract provides for termination only in the event of cause, in today's world it may amount to much less than it appears to say. In the event of a takeover, it is entirely possible for the new owners either to make the situation totally unacceptable for the executive—in effect, to drive him to resign by one means or another, such as reassignment of duties; relocation or ostracism; or to breach the contract and force the executive to bring a suit in which his performance becomes the issue. If the executive has opposed the tender offer, the new owner often has every incentive to do one or the other. And, even without that incentive, many owners will understandably want to bring in their own management. Let me offer a second example. A young, high-growth company often hires highly qualified managers on the promise of job security as well as substantial benefits emanating from the further growth and prosperity of the firm. Such a company would have a difficult time attracting the best candidates without providing a strong measure of assurance that the benefits accruing from the growth of the company, which typically vest only over a period of years, will not be arbitrarily cut off in the event of a tender offer and change of control of management. Indeed, such a company may be viewed by prospective employees as an especially high risk candidate for takeover for the very reason that it has a high-growth potential.

Providing special compensation in the event of change of control terminations makes it relatively easy for companies to avoid "front-loaded" arrangements—arrangements where the executive receives disproportionately high levels of compensation in advance, comparable to a signing bonus in sports. Instead, the current norm is for the executive to earn the right to higher compensation over a period of time—vesting of rights to specified percentages of options under stock option plans is a typical example. Front-loading can be avoided because the executive has received appropriate assurance that he will be able to complete his employment term. If protection against a change in control cannot be afforded, I believe it likely that front-loading will become more common. And, I don't believe that to be in the interests of companies or shareholders.

It therefore seems to me that great care should be taken not to adopt any remedy which will prevent the few cases of abuses that have occurred but which also will impact negatively upon companies seeking to attract or retain executives. While one may agree with the Advisory Committee that abusive compensation arrangements impair confidence in the takeover process, I note that the Committee did not suggest federal tax legislation as a general remedy. Traditionally, employment arrangements have been left as a matter for state regulation. The cases now pending may prove an adequate remedy. In any event, I am not convinced that addressing the problem through tax legislation not designed to raise revenue is appropriate. It is almost inevitably an overly broad approach that will impact upon employment arrangements adopted in the ordinary course of business. I agree with the Commission's suggestion that it is important to distinguish between arrangements entered into once a takeover is threatened and those adopted in the ordinary course of business.

I believe a key distinction should be whether the contract has been approved by shareholders. Whatever one may think of the level of compensation awarded by directors in a particular case, it seems to me that there is no federal interest in precluding companies from paying amounts which shareholders approve after fair disclosure. (In effect, the suggestion takes the same approach as the Congress has taken in the taxing of stock options where special treatment is afforded plans approved by shareholders.) If the Committee recommends legislation, I believe it should except any contract approved by shareholders after appropriate disclosure in accordance with SEC disclosure requirements. The suggested exception would also deal effectively with what I believe to be the real problem that destroys public confidence: contracts adopted as a tactical device in the face of a threatened takeover. Requiring shareholder approval makes such tactical use highly unlikely. Moreover, stockholders who dissent from the majority view will still be able to challenge questionable contracts on grounds of corporate waste. If shareholders approve a contract, it seems to me the only remaining federal interest is appropriately to tax "unreasonable" compensation; and that is already provided for in Section 162(a) of the Internal Revenue Code.

To summarize: I believe that there have been abuses but that the prudent course is to await the results of cases now pending. If a federal remedy is to be implemented now, I don't believe that using the tax laws as punitive regulatory measures—with no revenue purpose whatever—is appropriate. The way to achieve minimum federal intrusion in a complex area best left to state regulation and to the private sector is simply to except contracts approved by shareholders from any penalty or prohibition.

Let me comment briefly on some of the issues I see presented by the language of H.R. 4357:

1. The approach taken by H.R. 4357 appears in my view to be excessive. It appears to cover the entire amount to be received under covered agreements. It seems to me that prior compensation consistent with historic experience should be excluded.

2. Including the present value of all amounts to be received by the recipient raises a question whether the tax imposed is upon "income" in the sense of the Sixteenth Amendment. It appears to go beyond the traditional "constructive receipt" standards for cash-basis taxpayers.

3. I believe the proposed bill is ambiguous in several respects; in particular, in whether it intends to cover within Section 1257(c) such items as immediate vesting of stock option rights in the event of a termination. Such provisions are sometimes found in regular employment agreements as well as in change of control arrangements.

I appreciate the opportunity given me to present my views.

Chairman STARK. Thank you very much.

Ernie Christian? Are you and Mr. Moorhead together here, is that it?

Mr. CHRISTIAN. Yes. I will give our remarks, Mr. Chairman.

Chairman STARK. All right, proceed.

STATEMENT OF ERNEST S. CHRISTIAN, JR., AND DONALD V. MOOREHEAD, PARTNERS, PATTON, BOGGS & BLOW, WASHINGTON, DC

Mr. CHRISTIAN. Thank you very much, Mr. Chairman. My name is Ernest Christian. I am accompanied by my law partner, Don Moorehead.

I have to say, Mr. Chairman, at the outset, that——

Chairman STARK. Excuse me, Ernie, could you pull that mike—it does not go very far—a little closer?

Mr. CHRISTIAN. Is that better?

Chairman STARK. Thank you very much.

Mr. CHRISTIAN. I would say at the outset, Mr. Chairman, that I have to reiterate what the Treasury said. I am not persuaded that this subject of golden parachutes is an appropriate candidate for a tax solution. I think it would be far better to leave the question of addressing whatever maneuvers may occur in the context of a takeover struggle to Federal securities laws, if the subject is going to be addressed at all.

Having said that, Mr. Chairman, I do recognize that there is considerable sentiment in the Congress for a tax response to the phenomenon of so-called golden parachutes, and I shall attempt to suggest to the subcommittee some ways in which there might be an appropriate tax response if there is to be one.

Both pending legislative proposals, H.R. 4357 and the provisions in the Senate Finance Committee bill, are defective. Both are overly broad in their application, and seem to lack any particular standard for making distinctions between what might be the classic

11th hour golden parachute contract and, on the other hand, the broad array of very proper and ordinary executive compensation arrangements that should not be subject to any kind of a tax penalty.

There are many examples of the latter. The first one is, of course, in the recruitment of key employees. It is quite common to have arrangements whereby there is supplemental compensation provided for upon the hiring of a key employee. Frequently, this is the case in a medium-sized firm attempting to hire away a top-level guy from a large firm. He may have already accumulated substantial retirement and other benefits at his present large firm employer, and he cannot readily be lured away.

Frequently, in this situation and others, there are backloaded arrangements. One type of arrangement is as follows. I earn a bonus in 1984 and I am subject to what is called the golden handcuff in that I earned a bonus of $100X in 1984 but I will not receive that $100X in 1984. I will receive $30X of it in 1985, $30X of it in 1986, and the remainder in 1987, provided I am still working and performing my duties. That is the idea of the golden handcuff. The company wants me to stay.

It is quite reasonable and quite common that an executive would seek to be protected against the risk of losing those deferred or targeted amounts that are put off. He would seek to be protected from losing those amounts because of the intervention of some extraneous event that he cannot control that prevents him from working, such as death or disability.

If he is in a small-sized firm or medium-sized firm that could be a target of a takeover, it is quite intelligent for him to say, "In addition, I would like to be protected against the risk of losing the opportunity to earn those amounts in the event that there is a takeover."

These are all amounts of compensation that have been bargained for in the ordinary context of the marketplace, not in the attenuated strange atmosphere of the context of a takeover. Rather, just in the ordinary process of hiring and seeking to retain employees.

So, this is an amount of compensation that the employee already is entitled to, or is reasonably entitled to anticipate earning, and it is inappropriate to penalize him or the company if he seeks to be protected against losing that amount.

That is quite different, I believe, Mr. Chairman, from a situation in which in the context of a takeover contest, someone seeks to obtain and does obtain something that he does not now have.

If the committee wishes to address the matter at all, it seems to me that the only thing you should address is the situation where an employee obtains something additional that he does not already have, and obtains that in the context of a takeover struggle.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ERNEST S. CHRISTIAN, JR., AND DONALD V. MOOREHEAD, PARTNERS, PATTON, BOGGS & BLOW

Mr. Chairman and members of the Subcommittee: I am Ernest S. Christian, Jr., a member of the Washington, D.C., law firm of Patton, Boggs & Blow. I am accompanied by my law partner, Donald V. Moorehead. We appreciate the invitation of the

Subcommittee to comment on the subject of so-called "golden parachute" agreements.

There have been several well-publicized cases in which high ranking corporate officials of a company that was the target of a takeover effort received what some have regarded as generous "eleventh hour" severance packages. Legislation has been proposed to impose substantial tax penalties on such "golden parachute" agreements. These legislative proposals are defective. They would impose tax penalties with respect to a number of ordinary and proper employment and compensation contracts that clearly are outside the scope of whatever tax policy justification may exist for penalizing "golden parachute" agreements. This is true both with respect to H.R. 4357, the specific subject of today's hearing, and section 46 of the Deficit Reduction Tax Act, as reported by the Senate Finance Committee.

We are not persuaded that this subject is an appropriate candidate for a special "tax solution" beyond the long-standing rules of present law that business expenses are tax deductible only if they are "ordinary and necessary" and that compensation payments are tax deductible only to the extent they are reasonable in amount. Any tax rule which goes beyond these basic principles of present law is in reality more of a rule or regulation of substantive corporation law and practice than anything else. The tax law is overused as a regulatory device. We would prefer to see federal securities law and state corporation law continue as the regulatory focal points for maneuvers that occur in the context of contests for corporate control.

Nevertheless, there is substantial sentiment within the Congress for a tax response to the "golden parachute" phenomenum. Thus, our testimony suggests ways in which that tax response might appropriately be structured. Both the Finance Committee bill and H.R. 4357 generally focus upon payments which are to be made when employment is terminated incident to a change in corporate control. This approach is, we believe, far too broad. Many contracts which contain change of control provisions otherwise bear little or no resemblance to the "eleventh hour" golden parachutes that prompted the legislative proposals in the first place. Let me give several short examples to illustrate our concerns.

Consider first the recruitment of key employees. Many mid-sized corporations rely upon their ability to recruit senior management and technical personnel from external sources, including from larger corporations in the same comparable businesses. These mid-sized corporations typically find that they must provide special employment contracts to such individuals in order to induce them to forego the substantial retirement and other benefits they have with their current employer. These special contracts can of course contain a variety of provisions, but many include some form of supplemental retirement benefit to compensate the individual for the fact that he or she will be unable by reason of age to have sufficient years of service with the new employer to earn the maximum normal retirement benefit. These individuals often demand that their employment contracts contain provisions to the effect that their supplemental retirement and other benefits will vest (and perhaps become payable in a lump sum) in a variety of circumstances. Such circumstances frequently include disability and a change in control in their new employer, the occurrence of any one of which would preclude the employee from rendering the services necessary to receive the anticipated benefits. Where such guarantees are provided to new key employees, they are also frequently made available to existing employees holding positions of comparable or greater responsibility so as to maintain the necessary parity of benefits among such employees.

In cases such as these, the contrast with the "eleventh hour" golden parachute contract situation is apparent. There is no known takeover attempt against which an existing management group seeks protection. Changes in corporate control are typically not the only trigger event, and the employee would receive only that which he or she reasonably anticipated. The ability to attract new employees for key and senior positions is for many mid-sized corporations essential to the ability to compete effectively, particularly in industries where there are one or more extremely large corporations which are able to develop their own key personnel internally over many years and which are comparatively immune to successful takeover attempts. Ironically, if contracts such as these are equated for tax law purposes with the classic eleventh hour golden parachute contracts referred to above (as the proposed legislation does), the result could well be a substantial curtailment of executive recruitment from larger to smaller firms.

As a second example, consider the fact that an increasing number of corporations seek to use so-called "golden handcuff" provisions to retain exceptional employees within the corporation. One such device provides that a cash bonus earned in one year for superior performance will be paid in installments over a period of future years, with the installment payments being conditioned upon the employee's continued affiliation with the corporation. To illustrate, an employee in 1984 may receive bonus payment installments attributable to bonuses initially awarded in 1981, 1982 and 1983. In these cases, the employee may properly ask for reasonable contractual protection against the loss of future installment payments where his or her ability to perform services in those years is precluded by death, disability or loss of employment incident to a takeover.

The contrast between these situations and the classic golden parachute is self-evident and such situations appear not to have been contemplated by the original legislative proposals. Yet, these arrangements, which have vastly different purposes and frequently have multiple payment triggers, are treated by the proposed legislation in a fashion identical to the clasic golden parachute.

Finally, some corporations, as a standard practice, now provide key senior management with severance guarantees which may be triggered by a variety of events ranging from disability to a change in ownership. This practice has many purposes, including assuring impartial consideration by senior personnel of both friendly and unfriendly takeover bids, and may be undertaken by some mid-sized corporations which have recruiting needs and practices similar to those I have just described. While these situations may resemble classic golden parachutes in some respects, they are far from the eleventh hour attempts to protect the management groups at which the pending legislative proposals appear to be aimed.

The preceding examples (and there are no doubt many others) clearly illustrate that the scope of the proposed provisions, as they are presently drawn, is far too broad. Even if tax policy is to be used to discourage, and perhaps indirectly to prohibit, golden parachutes, it is obviously necessary to differentiate among the broad class of contracts that contain change of control trigger mechanisms. Not all contracts which contain change of control trigger mechanisms are the same. They differ significantly in composition, in history and in use.

For these reasons, if special tax penalties are to be applied to "golden parachutes," we urge that the Subcommittee seriously consider revising the proposed legislation so that the penalties would not apply in situations where an employee is given protection with respect to compensation or benefits that he or she reasonably anticipates ultimately receiving absent a termination of service for reasons beyond his or her control and the amount of such compensation or benefits is agreed to other than under the pressures of an actual or immediately threatened contest for corporate control. Agreements containing change of control provisions should be exempt from the penalties if they provide for the payment of benefits to which the employee has a legitimate anticipation and to which the employee would be entitled if his or her service was interrupted by events other than a change in control.

Such a rule, if properly drawn, would protect agreements in cases such as those I have described where the purpose of the agreement is to recruit and retain the services of key employees and to provide the parity of benefits among key employees. This approach is necessary to prevent the application of the proposed special and harsh tax penalties to situations which simply do not arise in the context of the factual patterns to which the proposed legislation appears designed to respond.

Mr. Moorehead and I would be pleased to answer any questions the Subcommittee may have.

Chairman STARK. Thank you.

Mr. Profusek, please proceed in any manner you prefer.

STATEMENT OF ROBERT A. PROFUSEK, ESQ., JONES, DAY, REAVIS & POGUE, DALLAS, TX, ACCOMPANIED BY DENNIS DRAPKIN, ESQ.

Mr. PROFUSEK. Thank you, Mr. Chairman.

My name is Robert Profusek. I am a partner in the Dallas office of Jones, Day, Reavis & Pogue. I am not a tax lawyer and therefore took the liberty of asking my partner, Dennis Drapkin, to accompany me.

I am a corporate lawyer specializing in merger and acquisition transactions, particularly hostile takeover transactions, proxy contests, and similar kinds of transactions.

It is rare, I suppose, to be the last person on a panel and to say that I agree with most everything that went on before me, but I do and therefore I will not take up your time in reiterating what has already been said.

Instead, I would like to emphasize four points, each of which are explained in more detail in my written statement.

The first is perhaps somewhat repetitive but there is a fundamental difference between so-called golden parachute contracts that are entered into in the face of an outstanding takeover bid and those that are entered into as a matter of what has become standard executive compensation policy.

For a company whose shares are widely dispersed in a nonregulated industry, there is no such thing any more as being immune from the risk of takeover. Takeovers can be good or bad, I do not believe that they are necessarily bad, but they are not necessarily good, either.

As a result, executives, successful executives in successful companies, have looked at these contracts primarily to deal with a risk over which they have no control and that bears no relation to whether or not they are successful and good managers of their companies.

There are alternatives for these people—companies that do not have substantial takeover risks—whether that be because they are privately owned, are in regulated industries, or have major blocks that in effect make a company what is referred to as bullet proof in this business.

Therefore, the distinction that seems to have been drawn by the witnesses here between arrangements entered into as a part of the normal course of business versus those that are put into effect in response to a specific set of circumstances may well have some merit, I think, in the tax context.

I would also like to point out that the Senate Finance Committee's proposal, has some significant problems associated with it and to a large degree the comments that I just made really relate to the underpinnings of those problems.

The 200-percent threshold in section 46 of the Senate bill may well cause so-called golden parachute arrangements that are entered into well before a takeover bid and that are designed not to do anything else other than to give an executive employment rights to be subject to what is clearly intentionally punitive tax treatment.

It seems to me that that kind of treatment is decidedly inappropriate.

The idea of requiring shareholder approval of golden parachutes is an interesting one, but I am not sure it is one that will really, in the end, solve the problem. For one thing, for the Tax Code to require shareholder approval would inevitably be an intrusion on State law corporate governance concepts, and it was this issue which by and large led the SEC to conclude not to accept the recommendation of the Advisory Committee on Tender Offers that golden parachutes be subjected to an advisory vote by shareholders. It was essentially a decision to maintain the integrity between Federal and State law.

Second, I do not think that it would really accomplish anything that really is not accomplished already. My personal feeling is that if stockholder approval were required, in most situations in which a takeover was not an existent threat, stockholder approval would be very easily obtained. The result of having to seek shareholder approval would be merely to disclose something about the contracts.

I think that disclosure in this area is already expressly required. Under a recent amendment to the SEC disclosure requirements, change in control arrangements have to be explained in great detail. And the necessity to make public disclosure of these arrangements while they are entered into in the ordinary course of business to a large degree, I think, controls many of the abuses that might otherwise be present, if only for the old slogan that "Sunlight is the best of disinfectants."

So, in conclusion, I would like to say that I think that the subcommittee needs to think hard about the proposals that are before it and resist what I regard as the obvious political pressure to do something about some possible abuses here.

In the process, I strongly encourage that the efforts of the subcommittee be directed only to these abuses.

[The prepared statement follows:]

STATEMENT OF ROBERT A. PROFUSEK, JONES, DAY, REAVIS & POGUE, DALLAS, TX

I. INTRODUCTION:

A. Background:

My name is Robert Profusek. I am a Partner in the Dallas office of Jones, Day, Reavis & Pogue, specializing in contested takeovers, mergers and acquisitions and corporate governance issues generally.

Jones Day is a national law firm, with more than 350 lawyers located in Cleveland, Columbus, Dallas, Los Angeles and Washington. Jones Day is actively involved in the provision of legal services to a wide variety of participants in the takeover process. However, the views expressed by me today are solely my own.

I have been extensively engaged in advising companies in the planning, initiation and consummation of tender offers and proxy contests, in takeover defense planning generally and in the defense of publicly announced and other takeover bids and proposals. I have also authored about a dozen law review articles concerning a variety of subjects in the takeover and executive compensation areas, including a recent article published in the Corporation Law Review on so-called "golden parachute" contracts,1/ and have spoken in a variety of public fora on various takeover subjects, including before the Advisory Committee on Tender Offers in June of 1983.

B. Summary of Position:

1. The public perception of a need for action in this area results in large part from adverse publicity generated by occasional abuses and a public misunderstanding of the purpose and effect of change-in-control executive employment contracts. The vast majority of such contracts are structured so as not to provide the executive materially greater compensation and benefits than he or she could have reasonably anticipated absent a change in control;

2. While there are occasional abuses in this area, there is not a sufficient federal interest to justify special tax legislation. Congress and the Securities and Exchange Commission ("SEC")

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1. Profusek, Executive Employment Contracts in the Takeover Context, 6 Corp. L. Rev. 99 (1983).

are presently actively considering the recommendations of the Advisory Committee on Tender Offers, including as to change-in-control executive employment contracts. It would be inappropriate to enact special tax legislation which would have the effect of preempting that process;

3. Punitive tax legislation would most likely operate against the interests of public stockholders because the result of enactment of the proposed legislation would be for many companies simply to adopt straight employment agreements the effectiveness of which is not conditioned upon a change in control;

4. If special tax legislation relating to change-in-control employment contracts is determined to be in the public interest, significant changes in the bills now in Congress appear to be necessary:2/

   (a) The complete disallowance of a deduction and the imposition of the 20% excise tax on the

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2. While it is understood that the Committee technically has before it H.R. 4357, the remarks herein are directed toward the text of Section 46 of the Deficit Reduction Act of 1984 reported out by the Senate Finance Committee on April 2, 1984.

entire amount payable under a "golden parachute contract" if the 200% threshold is exceeded by even $1.00 seems punitive and unreasonable; and

(b) The concept of comparing the present value of all amounts due under a "golden parachute contract", which typically run from three to five years, to prior compensation in one year also seems punitive and unreasonable because it may well result in the imposition of special taxes even in situations in which the executive's compensation and benefits are not materially increased after a change in control.

II. GENERAL ANALYSIS:

A. The Evolution of Change-in-Control Contracts:

The number and transaction size of nonnegotiated corporate takeovers have increased dramatically in recent years. The cash (or part-cash) tender offer -- once thought to be a tool solely of corporate raiders -- has come to be perceived by many in the business and financial communities as an acceptable and preferred acquisition technique. At the same time (and perhaps as a result), the nature of typical target companies has changed dramatically. While hard data are not available, it is commonly believed that typical target companies in the current environment are successful, often multi-billion-dollar participants in their particular industries which are managed by capable personnel but are not adequately valued in the United States securities markets.

In this setting, there is a growing understanding that top-quality executives may be likely to seek more secure career opportunities if a takeover is a real possibility, and a substantial number of companies have encountered difficulties in recruiting or retaining qualified senior executives unless some form of employment security arrangement is offered. Accordingly, the directors and managements of many publicly held companies have given increased attention to various types of such arrangements, including executive employment contracts which become operative only upon the occurrence of a change in control of the contracting company.

B. Purpose and Effect:

The popular perception of change-in-control contracts is that they are "anti-takeover" devices or mere nest-feathering by incumbent management. Indeed, the Senate Finance Committee proceeded from these assumptions.3/ These perceptions and assumptions are inaccurate:

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3. The Senate Finance Committee concluded, among other things, "that in many instances golden parachute contracts do little but assist an entrenched management team to remain in

(footnote continued on next page)

1. Not Anti-Takeover Devices: Except in highly unusual circumstances, executive employment contracts are not designed to be, nor are they, effective shark-repellent measures. The costs normally involved in acquiring control of a public company pursuant to a tender offer make the obligations under such contracts comparatively insignificant even if the bidder does not intend to retain target company management.4/ Moreover, the managements of many target companies in the current environment are among such companies' most valuable assets (as is evidenced by the very common practice of signing up target company management to long-term contracts in negotiated takeovers). As such, executive employment contracts will not aid in ensuring against vulnerability to a tender offer.

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3. (footnote continued from previous page)

control," S. Fin. Comm., Explanation of Provisions Approved by the Committee March 21, 1984, 98th Cong., 2d Sess. 195 (1984), and that such contracts "also may provide corporate funds to subsidize officers and other highly compensated individuals." Id.

4. For example, the often-discussed Conoco contracts involved in the aggregate about 1/10th of 1% of the consideration paid by DuPont to acquire Conoco.

2. Not Nest-Feathering: While exceptions do, of course, exist, most change-in-control contracts are designed so as not to increase materially the compensation and benefits which the executive could reasonably expect absent a change in control.5/ All that they do is remove the possible adverse effects of a risk that even the very best managements cannot control.

Only a small number of the existing change-in-control contracts have been adopted in the face of actual or overtly threatened takeover bids.6/ Rather, they have become an increasingly standard employment compensation technique with four principal purposes:

1. Maintaining High-Quality Management: The contracts are designed to provide security against a risk over which the company has no effective control. In the current environment, they may be critical in attracting and retaining top-quality senior management -- a high-quality manager may

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5. Exhibit A consists of a chart setting forth summaries of the principal terms of a random sampling of such contracts.

6. *See generally* Dwyer, *"Golden Parachutes" and Corporate Takeovers -- A New Survey*, Corp. Guide (P-H) ¶ 26,453 (Jan. 18, 1983).

be disinclined to accept employment or may be inclined to seek other employment in a situation in which the risk of a takeover is significant.

2. Ensuring Management Objectivity: The contracts aid in ensuring that management is able, as a practical matter, to evaluate an unsolicited takeover bid objectively.

3. Target Response: A board of directors may properly choose to resist a particular takeover bid to buy time to solicit a better offer or undertake some other transaction providing a greater return to shareholders.[7] However, target management normally bears the brunt of any defense. Change-in-control contracts may be important to enable the target company to resist an inadequate or illegal takeover bid.

4. Basic Executive Compensation Considerations: Unsolicited takeover bids are usually made at substantial premiums over market prices. In many circumstances, the individuals who are most

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[7] See, e.g., Bebchuk, The Case for Competing Tender Offers, 95 Harv. L. Rev. 1028 (1982). But see Easterbrook & Fischel, The Proper Role of Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1982).

directly responsible for the progress and development of the target company should be awarded financial and job security for the same reasons that justify other executive compensation arrangements.

C. Business Judgment Rule:

Although litigation has been instituted,[8] no published judicial decision addresses the validity of change-in-control executive employment contracts (outside of regulated industries such as the thrift industry). However, most state corporation statutes expressly authorize corporations to pay appropriate compensation to their officers.[9]

Accordingly, the business judgment rule -- which, in general, ensures that director actions taken in good faith and

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8. See, e.g., GAF Corp. v. Werner, No. _____ (N.Y. Sup. Ct.) (Mar. 5, 1984) (Complaint).

9. E.g., Del. Code Ann., Tit. 8, § 122(g) (1981). See also id. § 141(b) (compensation of directors). Most state statutes also provide that a contract between a corporation and a director is not void or voidable solely because the director is present in a meeting at which the contract is approved if the director's interest is fully disclosed and the contract is approved by a disinterested majority of the directors. E.g., id. § 144(a). Such statutes do not, however, immunize such a contract from attack; rather, they merely ensure that the contract cannot be attacked on the basis of the director's interest alone.

for a proper business purpose will be upheld -- is the appropriate standard for evaluating executive employment or termination agreements adopted pursuant to the statutory authority granted in respect of executive compensation generally.10/ Under these principles, the vast majority of change-in-control executive employment contracts are clearly valid under state corporation law.11/

D. SEC Disclosure Requirements:

Under a recent amendment, Item 402(e) of SEC Regulation S-K expressly requires disclosure of the material terms of change-in-control employment contracts in any proxy statement if action is to be taken with respect to, among other things, the election of directors. Item 602 of SEC Regulation S-K requires that an employment contract to which any director or one of the five most highly compensated executive officers is a party be filed as an exhibit to certain registration statements (including registration statements on Forms S-1 and S-14) and to annual reports on Form 10-K. Finally, Item 3(b)

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10. Other commentators have concurred. E.g., Fleischer & Raymond, Whittaker-Brunswick Bid: Study in Takeover Defense, Legal Times, at 18, col. 1, 28, col. 4 (June 28, 1982).

11. Different statutory or administrative standards may technically apply to contracts entered into by banks, savings and loan associations and other companies in regulated industries. However, the above-discussed general principles are in most instances equally applicable to those companies.

of Schedule 14D-9, which is required to be filed in connection with the publication of any solicitation or recommendation by the target company with respect to a tender offer, requires disclosure (or an express cross-reference to a prior stockholder communication) of any material contract between the target company and its officers and directors. While it is not clear that all executive employment arrangements meet the materiality threshold for disclosure pursuant to Schedule 14D-9,[12] most target companies elect to report employment contracts in response to this requirement.

Sunlight is, of course, very frequently the best of disinfectants. The existence of these disclosure requirements, of itself, significantly reduces the risk that abuses will occur in this context.

Moreover, the SEC Advisory Committee on Tender Offers recommended that Congress or the SEC adopt two other substantive requirements in this area: (1) a prohibition against the adoption of such contracts in the face of an outstanding tender offer and (2) a requirement that such contracts be annually voted upon, in an advisory fashion, by stockholders. While these recommendations have been criticized,13/ they are under active consideration by Congress and the SEC. It is respectfully submitted that the issues raised by change-in-control employment contracts ought to be considered in these contexts, rather than dealt with as a matter of tax policy.14/

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[12] In Missouri Portland Cement Co. v. Cargill, Inc., 498 F.2d 851 (2d Cir.), cert. denied, 419 U.S. 883 (1974), for example, the Court of Appeals for the Second Circuit held that long-term executive employment contracts entered into in the face of an unsolicited takeover bid were not "material" to the target's stockholders. See also Altman v. Knight, [1977-1978 Decs.] Fed. Sec. L. Rep. (CCH) ¶ 96,040, amended, 431 F. Supp. 309 (S.D.N.Y. 1977); Graphic Sciences, Inc. v. Int'l Mogul Mines, Ltd., 397 F. Supp. 112 (D.D.C. 1974).

III. PROPOSED TAX LEGISLATION:

If, however, it is determined that tax legislation in this area would be in the public interest, it is respectfully suggested that certain changes are required in the language of Section 46 of the Senate bill:

(i) Amount Taxable: As written, if the present value of all amounts payable under a "golden parachute contract" exceeds the historical threshold by even $1.00, the entire amount actually paid is

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13. Including by the undersigned. *See, e.g.*, Profusek, *Golden Parachutes*, 8 Directors & Boards 33 (1984).

14. In this regard, it should be noted that on March 8, 1984, John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy, wrote Senator Chafee that the Treasury also has "some questions as to the necessity of addressing ["golden parachute"] agreements, troubling as they are, through the income tax provisions, or whether they can be better addressed through the regulatory arm of the Securities and Exchange Commission."

non-deductible and is subject to the 20% excise tax. In my view, only the amounts actually in excess of historical compensation should be the subject of special treatment.

(ii) Comparability: The Senate bill compares the present value of the amounts payable over the life of a "golden parachute contract", which normally are from three to five years, to the recipient's highest compensation in any one of the preceding five years. As mentioned above, while there are exceptions, the underlying principle of most change-in-control contracts adopted to date is that they not provide the executive materially greater compensation and benefits over the life of the contract than he or she could have reasonably expected absent a change in control. Yet, even if this is true, the Senate bill's concept of comparing compensation which may be payable only over, for example, a three-year employment period to one prior year's income could easily result in punitive tax treatment being accorded to an executive who in fact continues to work in precisely his current circumstances at, or perhaps even below, his prior rate of compensation. Surely, that result ought to be avoided.

(iii) Scope: Most of those agreements perceived as abusive were adopted after a tender offer had been made. The scope of the Senate provision should be similarly limited to reduce the probability of affecting clearly non-abusive agreements (although change-in-control contracts may be validly adopted even in this setting).

(iv) Excise Tax: The 20% excise tax on amounts paid under "golden parachute" agreements contained in the Senate bill is punitive, and should be eliminated entirely.15/

(v) Reasonableness: The conference report should state that factors that indicate that a "golden parachute" agreement is reasonable, for purposes of deductibility, include, at a minimum, (a) the need for such arrangements in order to attract and retain key managers, (b) the need for the arrangement to ensure management objectivity and effectiveness in evaluating an unsolicited takeover bid and appropriate management action in

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15. In the March 8, 1984 letter to Senator Chafee, refered in note 14 above, Assistant Secretary Chapoton failed to endorse any form of excise tax on the receipt of "golden parachute" payments.

> responding to such a bid, and (c) the contribution that the individuals covered by such arrangements make toward enhancing the value of the target company.

IV. CONCLUSION:

Bad facts really do make bad law, and sometimes bad policy. While there may be instances of abuse of change-in-control contracts, they are very small in number. One likely result of legislation like that proposed by the Senate Finance Committee will be that public companies will adopt straight employment contracts which are effective without respect to whether a change in control occurs. The losers in that event will be public stockholders since companies will thereby forfeit flexibility in making management changes prior to any change in control.

True, there may have been some abuses. However, I respectfully submit that the existing state substantive law and SEC disclosure requirements in this context are already entirely adequate, and already act as a substantial deterrent against abuses. Moreover, I believe that the issues raised by the proposed tax legislation would be more appropriately considered in the context of Congress' and the SEC's consideration of the recommendations of the Advisory Committee on Tender

Offers. Accordingly, I respectfully urge that no tax legislation be enacted at this time, or if enacted, that the Senate proposal be amended substantially.

Robert A. Profusek

April 12, 1984

REPRESENTATIVE EXECUTIVE EMPLOYMENT CONTRACTS AFFECTED BY OR OPERATIVE IN THE EVENT OF A CHANGE IN CONTROL Exhibit A

Company	A	B	C	D	E	F	G	H	I
BASIC APPROACH	Springing employment	Springing employment	Springing employment	Supplemental pension arrangement	Springing employment	Employment agreement	Lump Sum	Lump Sum	Springing employment
"TRIGGER" DEFINITION	1 Tender offer for 20% or more of voting securities 2 Merger resulting in less than 75% of stock owned by former shareholders 3 Sale of substantially all assets 4 Acquisition of 20% or more of voting securities by any person	1 Ownership of 25% or more of voting securities 2 Change in majority of directors voted on by Executive over 24 month period	1 Ownership of 20% or more of voting securities 2 Merger resulting in less than 75% of stock owned by former shareholders 3 Transfer of substantially all assets 4 Three or more new directors elected despite opposition of majority of board of directors 5 Change in majority of directors in any 24 month period within 5 years of a tender offer	1 Tender offer for 25% or more of voting securities 2 Merger resulting in less than 75% of stock owned by former shareholders 3 Sale of substantially all assets 4 Acquisition of 25% or more of voting securities by any person	1 Merger, consolidation or sale of all assets 2 Acquisition of 20% or more of voting securities by any person	Change in Control (not defined)	1 Acquisition of 30% or more of voting securities by any person 2 Merger resulting in less than 50% of stock held by former shareholders 3 Sale of substantially all assets	1 Ownership of 30% or more of voting securities 2 During any 2 year period, change in majority of directors or election of directors nominated by shareholders not approved by 2/3 of the directors	1 Merger resulting in less than 75% of the voting securities held by former shareholders 2 Sale of substantially all assets 3 Acquisition of 20% or more of voting securities by any person
EFFECTIVE PERIOD AFTER CHANGE IN CONTROL	The earlier of 1 Age 65 2 Death or disability 3 Voluntary termination 4 Termination by Employer for cause	The earlier of 1 End of Period of Employment (which commences upon execution of contract and ends on a specified date) 2 Death	The earlier of 1 5 years 2 Age 65	Age 65	Full Term: From change in Control to the earlier of 1 Age 65 2 5 years 3 Death or disability 4 Voluntary termination 5 Termination for cause Limited Period: Effective from voluntary termination or disability to the earliest of 1 Age 65 2 5 years 3 Death 4 Termination for cause	Certain provisions effective upon actual or likely Change of Control (See "Benefits" below)	1 1 year if termination involuntary 2 2 years if termination voluntary	Six months	The earlier of 1 3rd anniversary of Change in Control 2 Age 65
EXECUTIVE'S RIGHT TO BENEFITS	Upon 90 days written notice if 1 Changed circumstances make him unable to carry out duties 2 On or after effective date a Change in Control occurs (upon Change of Control under items 2 or 3 in "Trigger" definition, above, or if persons in item 1 or 4 above acquire 50% or more of voting securities, or change of majority of board of directors)	1 Termination by the Company for any reason other than cause or disability 2 Termination by Executive due to a Removal from Board of Directors after Change in Control b Change in position or reduction of compensation c Changed circumstances after Change in Control make him unable to carry out duties d Breach by Company of contract provisions e Liquidation, merger, or transfer of assets where successor does not assume contract	1 Demotion 2 Changed circumstances make Executive unable to carry out duties 3 Breach of Company's obligations	Termination for any reason other than voluntary resignation	Upon 90 days written notice if changed circumstances make Executive unable to carry out duties	If not retained in present position Executive may terminate for any reason within 3 months	1 Involuntary termination within 1 year from Change in Control 2 Within 2 years if status or responsibilities diminished	Termination by Company or Executive within 6 months of any Change in Control if not for death, cause or disability	1 Change in or reduction of responsibilities 2 Office location moved more than 15 miles 3 Reduction of compensation or benefits 4 Election of early retirement if Executive at least 55 (some reduction in benefits) 5 Failure of successor company to assume employment contract 6 Termination by Company other than for cause
BENEFITS	1 Current benefits during Term, may be terminated by Employer only for gross malfeasance of duty 2 In event of voluntary termination a Lump sum equal to annual base salary plus award under Incentive Compensation Plan based on prior awards X number of years until age 65 reached b Full retirement benefits including protection of supplemental retirement	1 Base salary payable monthly 2 Monthly portion of Annual Incentive Performance Award 3 Current employee benefits during period of Employment 4 Lump sum for outstanding stock options 5 Irrevocable Letter of Credit from Company to Executive to insure payment by Company of Executive's legal expenses of enforcing the contract	1 Current benefits with normal increases during Term, no relocation 2 In event of voluntary termination without cause a Annual compensation continued for 3 years or rest of Term b Full employee benefits or economic equivalent c Exercise stock option or appreciation rights d Company to pay attorney's fees incurred by Executive in enforcement of Contract 3 In event of termination due to disability regular Executive disability benefits (stipulated maximum compensation), employee benefits or equivalent to age 65 4 In event of termination without cause after expiration of Employment Term, 1 year's salary and bonus	Monthly Supplemental Pension Benefits determined as if Executive attained age 65 and retired on Normal Retirement Pension Plan	1 Current benefits during Full Term 2 During Limited Period, continuation of base salary and employee benefit plans but not Incentive Compensation Plans (See Mitigation of Damages below)	1 Immediate exercise of stock options upon evidence of likely "Change in Control" 2 If Change in Control occurs in a 1979 lump sum of 5x annual compensation b 1980 4x annual compensation c 1981 3x annual compensation d 1982 or thereafter 2x annual compensation 3 Employee benefits for 18 months	1 Annual salary for 2 years 2 Lump sum of 2x Incentive Compensation Award 3 Employee benefits for 2 years or cash equal to cost 4 Full pension or equivalent annuity 5 Cash sum for stock options 6 Irrevocable Letter of Credit from Company to Executive in amount of $500,000 to insure payment of legal expenses of enforcing the contract	1 Lump sum on 5th day following termination in amount equal to a Full base salary through date of termination b Amount equal to product of annual base salary plus annual average incentive compensation multiplied by 2 2 Cash payment for stock options 3 Payment of legal fees incurred as result of termination 4 Retirement compensation, plus lump sum at retirement age equal to actuarial equivalent of retirement plan as if 4 additional years had been accumulated	1 Current benefits during Period of Employment 2 In event of voluntary termination or termination without cause a Lump sum equal to 1 Average monthly salary multiplied by number of months left in Period of Employment 2 1/12 of average bonus award multiplied by number of months remaining in Period of Employment discounted to present value at rate of 9% b During Executive's life, annual benefits paid monthly as provided under Supplemental Executive Benefit Plan (or 80% of such total as a lump sum) c Irrevocable letter of credit to Executive providing for payments under the employment contract d Company to pay any legal fees incurred in enforcing employment contract
NON-COMPETITION	If competes before age 65, must return portion of lump sum	Duration of Period of Employment	None	3 years	One Year	None	None	None	Two Years
MITIGATION OF DAMAGES	None	1 Required to seek equivalent but non-competing employment 2 Payments and benefits to be reduced correspondingly when new position accepted	After first year of benefits following termination any salaries and bonuses from subsequent equivalent employment to be deducted from payments	None	Upon voluntary termination 1 Required to seek equivalent but non-competing employment 2 If position accepted a Ineligible for employee benefits b Cash compensation from new employer offset	Non cash benefits cease if employed by competitor after termination	None	None	In event of voluntary termination or termination without cause 1 Executive to make reasonable efforts for 6 months to obtain equivalent but non-competitive position in convenient location 2 If other employment obtained within 6 months, Executive to refund lump sum
LENGTH OF CONTRACT	10 years with option of cancellation after 5 by Company	So long as Executive employed by Company	1 Expires on the earlier of a October 15, 1991 b Retirement at age 65 c Date of early retirement 2 Contract terminated by Company upon Executive's a Death b Termination for cause c Termination without cause (see "Benefits" above)	Contract is to be in effect from specified date	Duration of employment	Duration of employment	Duration of employment	Two years	Prior to Change in Control, may be terminated by board of directors after 3 years with 1 year notice

REPRESENTATIVE EXECUTIVE EMPLOYMENT CONTRACTS AFFECTED BY OR OPERATIVE IN THE EVENT OF A CHANGE IN CONTROL

Company	J	K	L	M (Version I)	M (Version II)	N (Version I)	N (Version II)	O
BASIC APPROACH	Lump sum	Springing employment	Springing employment	Springing employment	Lump sum	Version I Lump sum	Version II Springing employment	Lump sum
"TRIGGER" DEFINITION	1 Ownership of 20% or more of voting securities 2 If within 2 years of a tender or exchange offer, or as a result of a merger, consolidation, sale of assets and/or contested election there is a change in the majority of directors	Change of control (not defined) not approved by board of directors	1 Ownership of 20% or more of voting securities if not approved by Executive 2 Change in majority of directors for whom Executive voted 3 Material breach of employment contract by Company 4 Liquidation, dissolution, consolidation, merger or transfer of assets unless successor assumes all obligations of employment contract	1 If during any 24 month period within 5 years of a tender offer or other acquisition of securities by person(s) or merger, consolidation and/or sale of assets a A majority of the directors change b Chief Executive Officer terminated involuntarily other than for cause 2 Election at any time of 2 or more directors opposed by management	Change in control (Not defined)	1 Company ceases to be publicly owned 2 Acquisition of 20% or more of voting securities		Ownership of more than 5% of voting securities
EFFECTIVE PERIOD AFTER CHANGE OF CONTROL	Effective upon termination under specified circumstances following Change of Control	Employee has unilateral right to terminate for 1 year following Change of Control	The earlier of 1 35 months 2 September 30, 1987 (but at least 12 Months)	3 years	See "Length of Contract"	Specified date		Three months
EXECUTIVE'S RIGHT TO BENEFITS	1 Termination following Change in Control for any reason other than death, retirement, disability or cause 2 Termination by Executive for good reason following Change in Control due to a Change of duties or position, or removal/failure to re-elect to any offices b Reduction of salary or benefit plans c Improper notice of termination by Company (notice specified)	1 Termination by Executive within one year following Change in Control not approved by directors 2 If terminated by Company for any reason other than cause or disability, including a Assignment of inappropriate duties b Forced relocation under specified circumstances	1 Termination by Company for any reason other than for disability or cause 2 Termination by Executive upon occurrence of any of the following events a Non-reelection or removal from position or board of directors b Reduction in salary or in scope of position c Changed circumstances make Executive unable to carry out duties	1 During Period of Employment, so long as employed 2 Termination by Company for any reason other than for disability or cause 3 Termination by Executive upon occurrence of any of the following events a Non-reelection or removal from any specified office b Significant change of position or salary reduction c Changed circumstances following Change in Control make Executive unable to carry out duties d Breach of agreement by Company e Liquidation dissolution, consolidation, or merger, unless successor assumes Employment Agreement 4 Following Period of Employment, termination without cause prior to retirement date	1 Termination by Company for any reason other than cause 2 Resignation of Executive upon occurrence of either a Change in duties, reduction of salary, or breach of Employment Agreement by Company b Change in circumstances regarding his duties make Executive unable to perform his duties	1 Termination of Executive unless for cause 2 Changed circumstances make Executive unable to carry out duties	1 Change in duties, reporting responsibilities, or removal from positions 2 Reduction in or failure to increase annual base salary 3 Change in participation of Employee Benefit Plan 4 Forced relocation, reduction of vacation 5 Non-assumption of Agreement by Company's successor	Termination of Executive for any reason within 3 months of Change in Control
BENEFITS	Lump sum to be paid on 5th day following termination in amount of 1 Full base salary through termination date and amounts due under Incentive Compensation Plan 2 Amount equal to product of sum of annual base salary plus most recent award under Incentive Compensation Plan multiplied by 3 or (if less than 3) proportion of time before retirement, divided by 36 3 Amount equal to all awards accrued in complete performance project under long-term Incentive Compensation Plan 4 All legal fees incurred in connection with termination 5 Continuation of employee benefit plans including retirement benefits for 3 years (or receipt of similar benefits from new employer) with assignment of insurance after period of coverage 6 Lump sum at retirement age equal to actuarial equivalent of retirement pension	1 During Period of Employment specified base salary and all employee benefits 2 If terminated by Company for any reason other than disability or cause, or by Executive within one year after Change in Control a Continuation of minimum salary b Any vested benefits payable under retirement plans, plus compensating payment equal to sum that would have been vested in remainder of term of Employment Agreement c Insurance and medical coverage or cash reimbursement for equivalent through remainder of term of Employment Agreement	1 Amount equal to base monthly salary plus monthly portion of bonus under annual incentive plan on monthly basis for 35 months or until September 30, 1987, but at least 12 months 2 Continuation of all employee benefit plans for same period as above	1 During Period of Employment: Continuation of base salary and executive bonus, awards (minimum stipulated by formula), full participation in long term incentive program, continuation of perquisites and fringe benefits, continuation of all employee benefits including full retirement program 2 Upon involuntary termination by Company or Executive other than for disability or cause a Monthly amount equal to monthly base salary plus monthly portion of most recent bonus payable for 3 years after effective date and for at least 24 months following termination b Exercise of stock options and payments under long term incentive plans c Continuation of all employee benefits, including perquisites, fringe benefits and full retirement program during period in 2a above 3 Upon termination without cause prior to retirement after effective date: Lump sum equal to annual compensation (base salary plus most recent bonus under annual incentive plan)	If terminated prior to end of Period of Employment ("Period") 1 Lump sum equal to salary payments and deferred compensation reserve credits remaining in Period 2 Pro rata share of any bonus that would be payable in Period including termination plus bonus that would be payable in Period including last day of Period 3 In addition to Pension Plans, pension benefits as if he had remained in employment through Period 4 Continuation of incentive compensation and all employee benefits through Period 5 Company to pay reasonable legal fees incurred in enforcement of Employment Agreement 6 Lump sum payment of balance in deferred compensation accounts	1 Sum equal to total future salary and Incentive Compensation Plan payments due until end of Period of Employment discounted at rate of 9% per annum 2 Continuation of employee benefit plans during Period of Employment 3 Extension of stock option exercise period from termination date to end of Period of Employment 4 Continued participation in Long Term Performance Program 5 Payment of legal fees incurred in relation to termination	1 Monthly salary through termination 2 Monthly payment until end of Period of Employment of monthly base salary plus 1/12 of highest Annual Award under Incentive Compensation Plan 3 Continuation of employee benefit plans during Period of Employment 4 Extension of stock option exercise period from termination date to end of Period of Employment 5 Continued participation in Long Term Performance Program 6 Payment of legal fees incurred in relation to termination	1 Lump sum in the amount of 3 times Executive's compensation for prior year 2 Continuation of all non-cash benefits for 18 months 3 Retirement plan benefits plus lump sum at normal retirement age equal to actuarial equivalent of additional amount that would have been accrued in 3 more years 4 Cash for surrender of stock options
NON-COMPETITION	None	Unless Executive terminates within one year of Change in Control not approved by the board of directors, non-competition through remainder of term of Agreement	Competition prohibited while Executive receiving payments or benefits	Competition prohibited while Executive receiving payments or benefits	5 years	Three years		Upon employment by competitor, non-cash benefits cease
MITIGATION OF DAMAGES	Except for discontinuation of medical benefits upon receipt of similar benefits from new employer, no obligation	1 Minimum salary to be reduced by amount of earnings from new position 2 Insurance and medical coverage discontinued or proportionately reduced upon equivalent benefits received from new position	1 If terminated by Company for any reason other than disability or cause, compensation due Executive to be offset by compensation from new employment 2 If terminated by Executive as described in item 2 of "Executive Right to Benefits," above, no obligation to mitigate	1 If terminated by Company for any reason other than disability or cause, a Executive shall seek equivalent, non-competing employment within 24 months of commencement of payments b Compensation correspondingly reduced in respect of compensation received from new employment rendered no sooner than 24 months following termination 2 No obligation to mitigate if terminated without cause prior to retirement after Period of Employment	None	None		None
LENGTH OF CONTRACT	1 Employment term is the earlier of a Normal retirement date b Expiration of 3 years commencing on specified date (automatic annual renewal unless 3 months written notice given) 2 Executive to give 6 months notice to terminate Agreement	Initial term of 3 years and automatic annual renewal unless 3 months notice given	Six years	Three years	Nine years	From execution of agreement to the earlier of 1 Death or disability 2 Specified date		Prior to Change in Control Agreement is to be in effect from execution to the earliest of resignation, retirement, death or disability, or new employment

Chairman STARK. Thank you very much, Mr. Profusek.

Most of the employment contracts would deal with how an executive is compensated if he or she is terminated without cause. And to the extent that one of those kinds of determinations could be the loss in a tender offer or takeover, I think you are all saying that that should not work against the executive.

But if I further said that any contract—I guess what I am saying is, going to the other extreme, where somebody, and let us talk always in terms of 10-year contracts, somebody 5 years ago negotiated an employment contract and they are happy. They are going along and collecting their salary and accruing their options and everything else. Then, they suddenly read in the Wall Street Journal that you are the object of a tender offer, and to run in the next day and renegotiate that contract with special benefits that only plug in if that tender offer is successful, is what I see as the abuse area here—whether it is in the Tax Code or just social policy.

Would you all agree that that, on the one hand, is abusive and on the other is not? I mean, do we have some common ground there, Ernie?

Or that there is potential for abuse in this 11th-hour——

Mr. CHRISTIAN. I think you are talking possibly about two different situations.

One is the case in which I am this ordinary employee with my ordinary supplemental compensation that I have negotiated previously and I anticipate receiving it. I had a bad lawyer or I was not very astute when I did this, and I left out of my agreement some kind of protection against losing what I already have, in the event there is a takeover.

Chairman STARK. No, I am assuming that you were a good lawyer and if you are terminated, you are going to get every nickel—perhaps discounted to current value—that you are entitled to, including somebody having to project and perhaps go to arbitration over the value of a stock price because once a company is dissolved or bought, you cannot track that stock price any further anyway. So, there is a question of fact as to what a stock option is worth if it ceases because the company goes out of existence.

I do not quarrel with that if it was negotiated 5 years ago.

Mr. CHRISTIAN. The distinction I am trying to make is that there are two possible situations where a change in control trigger is put in.

One situation is the one I was referring to and that is, I now desire to have the change of control provision put in to go along with death, disability, abolishing my marketing department or something like this. I now desire to have that put in because I am now concerned about a takeover.

Chairman STARK. But would it pay more than disability or demolishing the department?

Mr. CHRISTIAN. No, sir. That is the distinction I am trying to make.

If I just simply come in and say, "Well, now protect me against being fired because of a change of control," and all I seek to be protected is what I already reasonably anticipate, that is one situation.

Chairman STARK. And you and I would say that there is no problem there.

Mr. **Christian**. I would certainly say that.

Chairman **Stark**. I would agree.

Mr. **Christian**. I think the other situation that you possibly have in mind is one in which I have an arrangement and my contract is so-and-so, and it provides me $10X or I anticipate $10X.

Chairman **Stark**. For termination under any circumstance.

Mr. **Christian**. And then I come in and say, "Well, we are about to be taken over, give me something now that provides me $50X," and I do that at the last minute. That is possibly a different situation and, I think, is possibly the one you are talking about.

Chairman **Stark**. That is the one. I guess I am trying to suggest that both in terms of, it is an 11th-hour shoestring catch and that the amount of compensation that is due upon severance is higher in the case of, say, a tender offer or an acquisition, than it would be under just the plant closing and consolidating divisions, for example. Or the boss' son-in-law takes over and doesn't like you and makes life unbearable and figuring it is better to buy you out of your contract and keep your own.

I think I am trying to get at a definition here where the problem seems to be so far out of the ordinary that it does seem like it might—Mr. Winter?

Mr. **Winter**. Mr. Chairman, I think most likely the single clearest indicia of a problem are contracts entered into at the last minute because in my judgment if they were believed to be appropriate as a corporate matter, they would and should have been entered into in advance.

One case which I am going to describe very loosely is indicative, with a company where a well-known raider took a significant stock position in the company. The senior managers awarded themselves contracts in effect to walk away with a significant percentage of the net worth of the company if the raider went on.

It seems to me, that sort of arrangement is highly questionable.

Chairman **Stark**. I think you hit it right on the head.

Mr. **Winter**. On the other hand, I think it is very difficult as a practical matter, given the complexities of arrangements and the additional risks that are imposed when a company changes control, to readily compare what the termination provisions are in different circumstances.

For example, somebody is retiring, he knows the management of the company. If his employment terminates it is anticipated that the company will continue with the ordinary course of business. He is willing to take that risk.

When you get changes of control, you also frequently get radical changes in the nature of the company. That is why in many circumstances these arrangements entered into well in advance were designed with special vesting or acceleration of certain benefits that would not be appropriate in the case of other sorts of terminations of employment, certainly not if the employee himself quit.

As a practical matter, in many of these instances, termination is not clearly a matter of quitting on the one hand or being fired on the other hand. Indeed, even in the case of a new owner who acquires the company, often he will want somebody to stay around for several months, it is in his interest, even though it is clear he wants to bring in his own man after some period of time.

So, it seems to me allowing companies flexibility in dealing with that side of the matter is appropriate. And if one feels that there are abuses that will not be cured by the present cases pending under corporate law and by the increased disclosure that one of my colleagues correctly emphasized as a matter that clearly is going to have a significant impact here, it would seem to me that really ought to be the focus of the Congress' concern—whether in the form of tax or other legislation.

Chairman **Stark**. I have one more concern that does give, I guess, some symmetry to this. We have done a lot recently to build in nondiscrimination rules, particularly in the pension area.

There have been concerns—even though I can think of the company I would not want to, but I have had expressed to me in some of the recent oil mergers that basically if you have two companies that basically just hold reserves, suddenly you have a whole office force and it is unnecessary. Really, the marginal extra people needed to double up are very small and there may be 300 employees who are going to be out of work and not all of those 300 are at the level of the golden parachute.

I am not talking here about those under bargaining units where those things are already, sometimes, bargained for, but I am talking about making these programs that deal with jobs eliminated be nondiscriminatory. Would you find objection to that?

Mr. **Profusek**. It seems to me that that is probably not a very practical solution for a couple of reasons. The first is, that in most instances the people whose security is really at risk in a takeover are not a very wide group of people. There are very few cases, especially outside the oil and gas takeovers, where all that the bidder is going after are assets.

Indeed, the management team in a broad sense that is in place in the target is usually one of the assets that is being sought by the bidder.

Chairman **Stark**. Well, I give you some examples outside of the oil business. A perfectly good one is the retail business—and I can use names here, I guess—where, say, Safeway in California will buy up 15 or 20 supermarkets with the obvious objective of closing them, picking up that market share, releasing, subletting the stores they pick up because they are on very favorable leases and literally putting out of work 200, 300 management-type nonunion employees just because they literally go in and close them up.

Now, to the extent that the owner of that small chain or the two or three highest paid executives had some protection, would it not seem consistent on the nondiscrimination provisions we have in pension law to say that it ought to be extended down to the next 15 or 20 middle management people?

Mr. **Profusek**. Well, the problem then is one of definition. I think those instances in which that maybe makes sense are rare in comparison to the cases in which there is not any substantial risk of that.

Second, most of those people are not in a position—at least to the degree that the most senior management people would be—to negotiate their own arrangements nor do they have the options that those people have.

Third, I think that one of the principal purposes of these contracts which, frankly, is regarded critically in some quarters, is to make sure that the people, the key decisionmaking people in the target company, are freed of personal concerns in order to permit them to respond to what could be a clearly inadequate, clearly illegal, or clearly bad, as a public policy matter, takeover bid.

I think that the people who say, well, those executives are paid so much money and why do they need any other kind of protection to insure that they in turn protect stockholders are taking a fairly naive view of things. Human nature dictates that if there is a substantial degree of risk associated with those individuals' personal futures, it has to affect their outlook and how they are going to respond to circumstances, and whether they are going to be willing to stand up and file law suits and do all the things that sometimes need to be done in order to get a fair deal.

So, there is a much smaller group of people that needs that protection if, as I believe, that is one of the purposes of these contracts.

It is primarily a matter of defining what it is that you are trying to do.

Chairman STARK. It is very quick to see, particularly in a widely held company, where the golden parachute can be worth more to the individual than a few bucks one way or the other in the price of the stock.

So, there would be a disincentive to file the law suits and protect against a takeover, and it actually would be an incentive that would perhaps work against the shareholder and the employee. Now, it seems to me if these guys are going to scuttle the ship, you ought to have life preservers for all the passengers. That is all I am suggesting on the nondiscrimination part.

Mr. WINTER. Mr. Chairman, I think it really works—experience has shown that it really works the opposite way. That it is those managements that, as my colleague was suggesting, that feel secure and know that if they antagonize the new owner by acting on behalf of the shareholders; it is those managers who in fact tend to act on behalf of the shareholders—if anything more readily than others.

I do not think—and I may be wrong because I am frankly not familiar with every contest that has gone on—but I do not think there are many instances in which one could plausibly interpret events as saying——

Chairman STARK. You cannot sell nondiscrimination is what you are telling me.

Mr. WINTER. Well, I think you are much better off leaving it to the judgment of boards of directors. I mean, if the whole structure of our corporate law is not a fiction, and I do not believe it is, then it seems to me, frankly, the fairly subtle considerations you are suggesting are best left to companies. In some cases companies go well beyond two or three people in who they deal with in this context.

Chairman STARK. Well, the one area where I have heard repeated a couple of times here, is that of shareholder approval as the benchmark? That certainly takes out the 11th hour. I mean, you are not generally about to run out and do a proxy solicitation to get shareholder approval while you have the corporate raider zooming over the horizon with his ray gun of special offers that are coming at you.

Mr. WINTER. I guess it was my suggestion originally, so let me at least try to address it first.

I think it is an idea worth exploring. I frankly do not think it is something that is so clearly advantageous that it ought to be written in a bill at this time.

I think the SEC's Advisory Committee suggested an advisory vote which I think is, frankly, fairly silly and I gather so did the Commission itself. They do not favor advisory votes in general. But I think it is something to consider. I know some companies have voluntarily submitted these arrangements because they simply feel their enforceability is much better assured. But I think that is something to consider. I would not press it at this point in time very strongly because I do not think it has been fully analyzed.

Chairman STARK. Just out of curiosity, has anybody ever filed a stockholder's suit to recover once a golden parachute has been distributed? Have they been successful?

Mr. WINTER. I think those cases are pending.

Chairman STARK. Bounce all around?

Mr. PROFUSEK. There are a number of cases pending. Some of them are very notorious, but there have not been any decisions. There have been a few out-of-court settlements for reasons that usually have nothing to do with the validity of the contracts.

I mentioned earlier that the stockholder approval idea is an interesting idea, and I am aware of your statements in the beginning in terms of deferral to other agencies or other bodies.

But the SEC did decide not to recommend that advisory vote concept in large part because it was concerned about the effect of that requirement on State law. What we are talking about in terms of validity rather than tax treatment is fundamentally a matter of State law. The decision was made that on this issue, which is the context of all the other issues that are before Congress and the SEC right now about takeovers, that that barrier between State and Federal law should not be breached on an issue which frankly is of less significance than some others.

We are struggling with a concept that will clearly preserve what is reasonable under the circumstances and what is not reasonable under the circumstances. I think the one thing that has been suggested to date that at least is readily easy to administer is the time dimension, when they are adopted.

Chairman STARK. I think there has been some concurrence, has there not, in the panel, that that is the area in which you might help both enforcement in terms of making some presumption as to whether it is reasonable and necessary and what the purpose was.

Mr. PROFUSEK. Yes. The problem with the Senate bill is that it does not really do that. I think that it is an effort to do that by establishing a presumption. But by having the 200-percent test in that bill——

Chairman STARK. That has a "cliff" problem, does it not?

Mr. PROFUSEK. Yes.

Chairman STARK. I mean, if you can get rid of that and find some——

Mr. **Profusek**. In a more comparable way to match it up, maybe that would be an appropriate way, too. But as written, and as I explained in my own statement, I think that is not an appropriate solution.

Chairman **Stark**. Ernie?

Mr. **Christian**. Mr. Stark, on the shareholder approval, I would dissent somewhat from what has been said. I think the subcommittee should be very cautious about injecting that into this process.

I think you would find that if you attempt to do that, you will get right back in the same definitional problem. Surely you do not intend to have shareholder approval, which is rather an extraordinary thing, for every ordinary kind of thing that goes down the pike that may happen to have a trigger in it related to a takeover.

So, you keep getting back to the question of what is the particular kind of arrangement that you want to get at. At the most, you would perhaps consider shareholder approval with respect to extreme 11th-hour arrangements.

But again, it is in fact not all 11th-hour golden parachute arrangements that are necessarily bad. That is one fundamental difficulty in attempting to address this subject in a tax context as opposed to the looser, more fluid fiduciary laws and rules in the corporate area. There are, in my own view, certain so-called 11th-hour golden parachute contracts that look exactly like others in terms of their timing and their quantities, but which actually perform a very useful and good function in the company and for the shareholders in giving top executives the freedom, the courage, or whatever, to resist a takeover.

So that I think the simple idea, or the idea of having a shareholder approval rule is not going to solve the problem, I believe, you are fundamentally concerned about.

Chairman **Stark**. Well, thank you all, and I certainly hope that you will come back before the Post Office and Civil Service Committee and help draft a golden parachute provision for Members of Congress, which will be timely if it is filed before primary filing dates close and will be binding on future Congresses.

Mr. Duncan.

Mr. **Duncan**. I have no questions. Thank you, gentlemen.

Chairman **Stark**. Thank you, gentlemen, very much. I appreciate your taking the time and the effort to come here today and comment on this legislation.

The committee will recess until 12:50 p.m., at which time we will hear from a panel comprised of Mr. David Storrs on behalf of several national associations of colleges and universities; Mr. William J. Farrell, vice president for educational development, the University of Iowa; Mr. Takabuki, the trustee of the Kamehameha Schools—it is easier to say the Bishop Estate—and Mr. William Morris and Mr. Peter Steil of the REEF Fund.

If you would all come forward, as soon as we take attendance across the street, we will resume.

[Recess.]

Chairman **Stark**. I am going to ask the panel to proceed in the order as you appear on the witness list. I think you were here for the Treasury's testimony earlier. To the extent that it is not covered in your prepared testimony, which will be part of the record, could you each deal with the problems that you would see generally in your own institutions if seller financing was prohibited if the partners in the partnership were all tax-exempt entities, and if you were prohibited from receiving leverage property through a donation which deals with that cross-over problem that the Treasury brought up.

Now, some of those you may be able to operate with and others you might not, but it would be helpful to the Chair if there were some compromise grounds here that the Treasury would not scream about. We would perhaps be able to achieve a compromise in conference which, I suspect, is part of the reasons for these hearings.

So, with those comments in mind, I would ask, I guess, David Storrs if he would like to lead off. Or if you have some other scenario in mind, please proceed.

STATEMENTS OF DAVID K. STORRS, DIRECTOR OF INVESTMENTS, YALE UNIVERSITY; WILLIAM J. FARRELL, ASSOCIATE VICE PRESIDENT FOR EDUCATIONAL DEVELOPMENT AND RESEARCH, UNIVERSITY OF IOWA; AND MATSUO TAKABUKI, TRUSTEE, KAMEHAMEHA SCHOOLS/BERNICE P. BISHOP ESTATE, HONOLULU, HI, ALL ON BEHALF OF ASSOCIATION OF AMERICAN UNIVERSITIES; NATIONAL ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES; NATIONAL ASSOCIATION OF INDEPENDENT SCHOOLS; AND NATIONAL ASSOCIATION OF STATE UNIVERSITIES AND LAND GRANT COLLEGES, ACCOMPANIED BY WILLIAM MORRIS, COORDINATOR

Mr. **Morris**. Mr. Chairman, if you would permit me, my name is William Morris, I am a partner with the law firm of Rogers & Wells. For the record I would like to state that the testimony this panel will present has been endorsed by a number of different educational organizations in addition to those that are stated on the witness list: The American Council on Education and the National Association of College and University Business Officers, in addition to the Association of American Universities, National Association of Independent Colleges and Universities, National Association of Independent Schools, and National Association of State Universities and Land Grant Colleges, endorses the testimony of the group.

I would like to introduce the panel and call on Mr. Storrs, who will testify first. Then Mr. Merritt will introduce Mr. Steil.

Chairman **Stark**. Proceed.

STATEMENT OF DAVID K. STORRS

Mr. **Storrs**. Thank you, Mr. Chairman.

I will not go through my prepared statement at length except to comment especially on the issue you just mentioned about how we, the Treasury, and others can come together on something that seems to fit all the needs which are essentially, as I understand it, to prevent the abuses that caused the imposition of section 514 in the first place 15 years ago and let us invest in a manner which serves the university clients we have.

Yale was founded in 1701. We currently have about 10,000 students, men and women, in every department. We receive about 10 percent of our income from our endowment fund. That figure is down from about 25 percent 15 years ago and obviously, therefore, supports far fewer scholarships and other educational costs.

The primary reason is that the stock and bond markets have had such poor returns. That has driven us to invest a large part of our endowment, about 10 percent, in real estate, equity real estate investments.

We are currently the largest university investor in equity real estate and have properties in a number of States around the country.

I can comment to you that a major reason for this is in part the better return which real estate has had, but also the fact that real estate is a much stabler holding than stocks and bonds with their inherent volatility, and in fact a number of studies have shown that real estate moves countercyclically with securities and therefore stabilizes your portfolio.

In our strategy, we do not use any leverage. The reason for that is the penalty tax caused by section 514, and that is a serious problem as I will comment on a couple of specific problems.

One is that unlike stocks and bonds, real estate is valued as if it included mortgage financing. In other words, it is priced at that level.

Chairman STARK. Can you give me an example of that?

Mr. STORRS. Yes. Typically, if you buy an office building you would expect to finance, let us say, 60 or 70 percent of that cost with long-term borrowings.

Chairman STARK. Yes.

Mr. STORRS. That is because you are matching long-term leases and safe assets with borrowings which themselves are also long term.

Stocks and bonds you would not want to finance with long-term debt because the value can erode very quickly.

Chairman STARK. Have you seen any properties offered lately with a cap rate higher than the commercial mortgage rate? I do not know, and I trade modestly in those kinds of properties and, for the life of me, I have not seen any. I mean, if you have seen a cap rate much above 10 percent, I would like to participate with you; and if you see mortgage, commercial mortgage rates below 12, I would like to get in line with you.

Now, therefore if you are in fact tax exempt, you are dealing with a negative leverage. You would be better off paying all cash, assuming you are going to buy a property that has a positive cash flow. You are better off paying all cash if you are tax exempt.

Mr. STORRS. You are exactly right, Mr. Chairman. Often, though, when you buy a property there is existing mortgage financing on that property which was taken out years ago when interest rates were lower.

Sometimes, there are serious prepayment penalties on that debt which cause you not to want to pay it off. It is also economically foolish to pay off, let us say, a 7-percent mortgage.

Chairman STARK. You do need help. Are you suggesting that you have problems if you bought something with an 8-percent loan with, say, 20 years left to go on it, and you are worried about the insurance company or the bank enforcing the prepayment penalty if you came hat in hand with a bag full of cash?

I just have a bill in that says the discount they want to give you for prepaying that loan should not be considered current income.

I mean, I certainly understand the advantage of leverage but I do find that that may change sometime in the future. If you assume a loan, yes. I mean, it is obvious but I cannot believe you are buying any commercial real estate property with assumable financing where the price has not marked that up. Again, I do not believe in either tooth or real estate fairies.

So, it just seems to me in a market where taxable investors are anticipating long-term increases in rents, they are willing to go under water or have reverse leverage to be in the long-term market.

But it eludes me as an investment objective why somebody who is tax free gets an advantage in the acquisition. That escapes me. I guess that is what I keep coming back to.

Mr. **Storrs**. Well, I think we agree completely that we would not leverage a property de novo. We would not take out new debt if we went to buy an office building at the rates we are seeing today.

So, in my comments I think I am really focusing on property with existing below market debt where it seems to me economic foolishness to deliberately pay off that debt early and share whatever savings exist with the insurance company or whoever else provided it by cashing in those savings.

But that is the effect, of course, of section 514 because if we do not do that, any profit we make on the building when we sell it will be all taxed at corporate rates and the income will be taxed in proportion with the leverage.

[The prepared statement follows:]

STATEMENT OF DAVID K. STORRS, DIRECTOR OF INVESTMENTS, YALE UNIVERSITY, NEW HAVEN, CT

Mr. Chairman and members of the Committee, thank you for the opportunity to comment on H.R. 676. I am Director of Investments at Yale University.

Yale is an independent, non-sectarian university founded in 1701. We currently educate about 5,000 undergraduate students and 5,000 graduate and professional students, both men and women in every department.

We have been under significant financial pressure in recent years. We utilize as productively as possible all our financial resources, especially the endowment fund. We currently draw about $40 million per year from the endowment for educational purposes. That is about 10% of the budget. In 1970, by contrast, the endowment provided about 25% of our budget. The endowment supported, in other words, more than twice today's proportion of scholarships, faculty, and other educational needs.

The primary reason for this decline is that returns on the stock and bond markets have been low, even with the recent stock market rise. That has led us to diversify the portfolio into other areas, especially real estate, where we now invest about 10% of our fund. We are also interested in real estate's stability as a means of dampening the volatility of the stock and bond markets.

We do not use mortgage financing, or leverage, when we make real estate investments. The simple reason is that the unrelated business income tax penalty imposed by Section 514 significantly reduces the after-tax return on leveraged properties.

The example on the attached sheet shows a $20 million investment in a property rented for $2.6 million per year, or 13%. That is the unleveraged return before any debt. If we could purchase that property with an existing 12% mortgage of $10 million, we would only need to provide $10 million of University funds. Also, we would increase Yale's annual return on its own equity investment from 13% to 14% because the interest rate on the existing debt is lower than the return on the property being purchased.

The first column on the attached sheet ("Year 1") shows that the cash return is initially reduced from 14% to 13.1% because of the unrelated business income tax. This is a 6.7% reduction in income to Yale. As the annual charge for depreciation reduces the "basis" of the property, the percentage of income which is subject to tax increases steadily until, beginning in year 11, 100% of the income is taxed (at 46%). This is true even though the debt does not change. Instead of earning 14% in year 11, because of the tax we earn 12.2%, or 13.1% less. The situation gets worse every year. Beginning in year 16, the tax reduces our return to only 7.6%, or 46% less than the untaxed return, because depreciation deductions no longer shelter income from taxation after year 15.

This is a simple example. If, as is more likely, income on the property were to grow over time, the tax would reduce Yale's income even more. While the particular assumptions as to income on the property, interest rate on the borrowings, depreciation schedules, etc. produce different consequences, it is almost always the case that the return to Yale on leveraged real estate investments is reduced by Section 514's taxation.

The first unfortunate result of this tax is that an otherwise attractive financial decision, to assume an existing below-rate mortgage, is made unattractive. The second unfortunate consequence is that a property which could have been purchased with a $10 million investment now requires $20 million, and only half as many properties can be purchased with a given amount to invest. A university is therefore less well diversified and more exposed to risk in its investment portfolio. The third problem is that a university devoted exclusively to educational purposes is required to choose between devoting part of its income to paying federal tax or turning down otherwise desirable real estate investments.

Those universities which engage in no "unrelated business income" activities are totally foreclosed from all leveraged investments, whatever the after-tax return may be.

Also, educational institutions will typically earn lower investment returns on real estate than will other tax-exempt funds, primarily retirement funds, which are not assessed the penalty tax. If a pension fund will earn 15% on a property and a university will earn 13.5% after tax, the pension fund can afford to pay 10% more than the university for the identical property. Especially given that retirement funds assets of about $900 billion dwarf the $35 billion of endowment funds, we see no need to discriminate in this manner against colleges and universities.

A special problem involves properties which need renovations. These might often be properties on the campus which produce income. Typically there is not enough income from such a property to pay for major renovations. The way a normal investor would handle this problem would be to finance the cost of the renovations and pay off the financing over time from income of the property. If we do that we will subject the property to income tax. Another unfortunate result of Section 514 is therefore that properties cannot be improved as much as we would like.

We believe that Section 514 acts for universities as a de facto prohibition on leveraged real estate investments, simply because we would never purchase properties with a 46% effective tax rate when we could purchase stocks, venture capital securities, bonds, and other investments on a tax-exempt basis.

The intent of Section 514 was not to reduce the ability of educational institutions to invest in real estate, or to reduce their returns on real estate, but to curb abuses. Section 514 results from the "Clay-Brown" problems many years ago. Those abuses involved partnerships between taxable and tax-exempt partners and overvaluation supported by seller takeback financing. Both abuses are prohibited in H.R. 676, and we believe continuation of this tax therefore serves no useful purpose.

The result of continuing Section 514 in its present form is therefore to prevent not abuse by colleges and universities, but proper investments in a market, real estate, which has provided and we expect will provide attractive investment returns. H.R. 676 would permit universities to use more prudently the donated endowment funds entrusted to them in perpetuity by stabilizing and increasing the return on those funds at no cost to the Treasury.

For all these reasons we support the passage of H.R. 676.

Thank you for your consideration.

Effect on Real Estate Return of Unrelated Business Income Tax

	Year 1	Year 11	Year 16
Gross income (13%)	$2,600,000	$2,600,000	$2,600,000
Interest expense (12%)	1,200,000	1,200,000	1,200,000
Cash flow	1,400,000	1,400,000	1,400,000
(as % of Yale investment)	14.0%	14.0%	14.0%
Depreciation	1,000,000	1,000,000	-0-
Net income	400,000	400,000	1,400,000
Average debt	10,000,000	10,000,000	10,000,000
Average basis	19,500,000	9,500,000	5,000,000
% income taxable	51%	100%	100%
Taxable income	204,000	400,000	1,400,000
Tax	94,000	184,000	644,000
Net return after tax	1,306,000	1,216,000	756,000
(as % of Yale investment)	13.1%	12.2%	7.6%
vs. untaxed 14%	-.9%	-1.8%	-6.4%
% reduction	-6.7%	-13.1%	-46.0%

Assumptions
1) $20,000,000 purchase price.
2) $2,600,000 annual rent (13% on purchase price).
3) $10,000,000 loan.
4) Interest-only loan payments at 12%.
5) 15 year, straight-line depreciation on 75% of purchase price (land value = 25%).
6) 46% tax rate.

Chairman **Stark**. Can you live with the Treasury restrictions that were suggested in the testimony this morning?

Mr. Storrs. I am sorry, the provisions on seller financing and all tax exempt partners?

Chairman **Stark**. Yes.

Mr. **Storrs**. Yes, sir.

Chairman **Stark**. And no donated properties.

Mr. **Storrs**. Yes, sir. Or we could live with H.R. 4170 and the so-called straight-up allocation rules. Either one of those accomplishes the purpose we are looking for which is to not traffic in tax shelters but to purchase real estate for its actual value.

Chairman **Stark**. All right, who wants to get into the fray next here?

STATEMENT OF WILLIAM J. FARRELL

Mr. **Farrell**. I am Bill Farrell, associate vice president of educational development research at the University of Iowa.

I am pleased to be here, Mr. Chairman, to speak on behalf of H.R. 676. I think all of us are sympathetic with what the Tax Reform Act of 1969 tried to do in putting an end to tax sham transactions which should never have existed to begin with. But in the process it also is today preventing justifiable investments in debt financed real estate for institutions of higher education.

What I would like to do in the next few minutes is to single out three disadvantages of that limitation.

First of all, as a result of that, development officers in universities and colleges do not normally seek out mortgaged property as a viable gift. I know our own director of development does not do that. I think that is a common pattern and that is unfortunate because mortgaged property could really be a great philanthrophic benefit to institutions of higher education, and especially today when obviously Federal and State support for public institutions and private institutions is declining.

One way of doing that, of course, would be to exempt mortgaged property from the unrelated business tax.

Second, the current situation also affects the flexibility with which we can deal with mortgaged property. For example, at the present time the University of Iowa Foundation, which is really our fundraising arm, purchased a building in downtown Iowa City. Now, they purchased it for the university's use. We use six of the seven floors and rent out the seventh, which is the bottom floor.

But the income received on that, according to the director of the foundation, is taxed at about a 20- to 30-percent rate. Now, they bought the building because the university wanted them to. But in fact, from a purely investment point of view, they would not make this kind of decision, and this has discouraged some very important investments that we might have otherwise entered upon.

For example, there was a plan to build some housing for junior faculty. We did not undertake that program through the foundation because of the current tax treatment.

I think it has affected our ability to do some things that would actually help communities in the area. For example, we have some farm land outside the city of Muscatine that really should be developed. To do that, we would have to obtain debt financing and the foundation is reluctant to do that from an investment point of view at the present time.

Chairman **Stark**. But can you not, in that instance, or could you not structure a lease that would give you all the earmarks of equity participation and still qualify?

Mr. Storrs is shaking his head.

Mr. **Farrell**. I think he had better respond to that.

Chairman **Stark**. It seems to me that you could lease that farm land to a developer and you could subordinate to mortgage loans for improvements. You have no interest in the depreciation or any of those tax advantages. So, it would seem to me you could get the same share of the income stream of that property through a lease and still be legal.

Is that not possible?

Mr. **Farrell**. I am an amateur here in this area.

Chairman **Stark**. So am I, but I will look to any of the pros out there to nod one way or the other.

Mr. **Farrell**. I think it probably has to do with persuading other entrepreneurs you want coming into the deal.

Why do not you respond to that?

Mr. **Storrs**. Sir, the way the rule works on that is that if, in fact, you are an economic owner and share in the profit of the enterprise which has leased the property from you, that lease income becomes taxable.

If on the other hand you are simply leasing the property for a share of gross revenue, it is not taxable.

Chairman **Stark**. Your position is that if you lease the ground, have no ownership in the improvements, and your ground lease is somehow related to the overall economic income of the property, you come under the debt finance.

Mr. **Steil**. The bottom line. You can participate in the gross revenues.

Chairman **Stark**. All right, in the gross revenues. In real estate, that tracks in any development. I mean, gross revenue is not very difficult to project net revenues out.

So, I guess what I was saying—and I want to get Mr. Steil to agree with me—is that you could structure a ground lease that would not be unrelated business income that would pretty closely parallel the return you might get, particularly if you are a tax-exempt organization, if you were a development partner.

Is that not a fair assumption?

Mr. **Steil**. You could. But there are costs attendant to that.

Chairman **Stark**. Well, paying attorney's fees to bright attorneys like yourself who could structure it, obviously, is part of that.

Mr. **Steil**. And the terms that an entrepreneurial developer would want in the context of dealing with a situation where he did not have fee ownership, which is not as attractive to him.

Chairman **Stark**. I know. Unless, of course, it is not as attractive unless you are structuring a tax shelter, and then it becomes very much more attractive because all of the money goes into the tax shelter side and that land which cannot be depreciated as held by your client——

Mr. **Steil**. And he has a purchase option.

Chairman **Stark**. Yes, it sounds like if we really put our minds to it here today, we could solve some of these problems.

If you would not mind, we will recess for about 7 or 8 minutes while I make this vote, and we will resume. Excuse me.

[Recess.]

Chairman **Stark**. I am not sure whom I interrupted. I was talking to Mr. Farrell, I believe. Did you want to add more to your testimony, Mr. Farrell?

Mr. **Farrell**. Let me just briefly conclude——

Chairman **Stark**. Please.

Mr. **Farrell** [continuing]. By saying two things:

One, to go back to the discussion we were having, whatever the reasons might be, whether the offer was not attractive to the developer that we would be dealing with or not, it is a matter of fact that such lands often do not get developed at the present time because of the current situation.

The only other thing I wanted to add was in response to your question to all of us, and that is, from the point of view of the University of Iowa, we certainly have no problem with the provisions which are included in the Senate committee's version, namely that the exception would be limited to property not financed by the seller or a related party.

Second, that in the case of partnerships each partner would separately qualify for the exceptions provided.

These seem perfectly reasonable and they would in no way diminish the value of the measure.

[The prepared statement follows:]

STATEMENT OF WILLIAM J. FARRELL, ASSOCIATE VICE PRESIDENT FOR EDUCATIONAL DEVELOPMENT AND RESEARCH, UNIVERSITY OF IOWA

Mr. Chairman and Members of the Subcommittee, my name is William J. Farrell, and I am the Associate Vice President for Educational Development and Research at the University of Iowa. I am pleased to be testifying today on behalf of House bill H.R. 676, a measure which would provide educational institutions with welcome relief from the unrelated business tax imposed on "debt-financed" real estate income.

In 1969, Congress took steps to prevent exempt organizations—including universities—from using tax benefits to pay for the acquisition of operating businesses. The tax-reform act of that year properly brought to an end tax-sham transactions that had no legitimate reason to exist. In the process of accomplishing this reasonable goal, however, it also prevented justifiable investments in debt-financed real estate for such organizations. This has created at least three serious disadvantages for institutions of higher learning.

Because of the penalty tax on debt-ridden real estate, an important source of private gift support is lost to colleges and universities. The director of our University Foundation informs me that his organization makes little or no effort to seek out mortgaged properties as contributions to our University. His practice is commonplace in the country today, even though most development officers regard mortgaged real estate as a potentially major form of assistance. In these days of declining public assistance on both the federal and state level, it is important that every reasonable encouragement is given to both institutions and contributors to increase private, voluntary support to higher education. A significant way in which that encouragement could be granted would be to abolish the unrelated business income tax on debt-financed real estate for universities and colleges.

In the past, this tax has not only restricted private sources of support for institutions of higher education, but it has also discouraged their use of gift revenue in the most flexible and productive ways. Let me give you a couple of examples. In recent years, at the request of the University, the UI Foundation purchased the office section of a large building in downtown Iowa City. Six out of seven floors in this building are used by the University for its own purposes. Nonetheless, under current law, the University of Iowa Foundation had to pay 20 to 30 percent of its net income on the remaining seventh floor as "unrelated business income tax." A claim for refund was denied by the Internal Revenue Service, because the facility was debt-financed. While the Foundation undertook this course of action in this case, it did so at a real loss to its income, considering other investment alternatives. Sometimes this lack of flexibility in using gift resources for mortgaged real estate results in the abandonment of worthwhile projects. One of the reasons why the UI Foundation was discouraged from undertaking a program to provide housing for young faculty, for example, was precisely because of the penalty tax on debt-ridden property income.

In addition to limiting the universities and colleges in meeting their own needs with gift resources, the current law also restricts the efforts of educational institutions to serve the investment needs of communities in their area. In the recent past, for example, the University of Iowa Foundation received a gift of 325 acres of land near the city of Muscatine. In the present economy, the Foundation would need to become involved in the development of this land to affect a sale, and, in so doing, it would have to undertake debt-ridden financing. Such real estate investments could greatly serve the interests of both the Foundation and the community. The current tax provisions of debt-financed investments for public charities diminished the incentives of pursuing this course, however. As a result, disposal of this property may have to await other economic conditions and the opportunity for an important development effort in an Iowa community will be lost.

It is our belief that Congress would help both higher education and the general economy by exempting educational organizations and affiliate foundations from the tax provisions that discourage debt-financed investments. House bill, H.R. 676, would be a major step toward accomplishing this goal, and it would do so without sacrificing the original legitimate objectives of the current law. In fact, the bill would simply extend to educational institutions an exemption that was granted to tax-exempt pension trusts in 1980. The measure is right in principle, and on that basis alone it has our unqualified support.

Those of us from public institutions are especially pleased to see that H.R. 676 extends the benefits of exemption, not only to educational institutions, but also to their affiliated support organizations as well. This is an important provision. Many publicly assisted universities including The University of Iowa, must rely for practical purposes on an independent private foundation to secure and to invest private contributions. About half of our revenue at The University of Iowa comes from non-state sources, and the UI Foundation plays an important role in contributing to that portion. It would be extremely limiting, therefore, to provide the benefits of exemption solely to those educational institutions that directly receive and invest gift revenues on a long-term basis. Even some private institutions are dependent on affiliated support organizations. Fortunately, H.R. 676 recognizes this complexity and extends the exemption to both affiliated support organizations as described in IRC Section 509(a) as well as qualified trusts. The Senate Committee on Finance also includes such organizations and trusts in the exception it provides in its legislative proposal.

In advocating an exception for "debt-financed" real estate income for educational institutions and their affiliates, we are sympathetic with the concerns of those who wish to prevent an inappropriate use of this provision. At the urging of the Treasury Department, for example, the Senate Committee limited the exception to property not financed by the seller or a related party. The Senate version further required that, in the case of partnerships, that each partner separately qualify for the exception provided. We have no trouble with these restrictions. Such limitations are reasonable, and they do not materially affect the value of this measure for the University of Iowa or other educational institutions. We want a bill that prevents abuse as well as meets the problem. Thank you.

Chairman STARK. Thank you very much.

Mr. Takabuki, I pronounced that correctly?

STATEMENT OF MATSUO TAKABUKI

Mr. TAKABUKI. Mr. Chairman, may I preface my remarks by thanking you for scheduling this hearing. I think it is extremely important to us.

My name is Matsuo Takabuki. I am a trustee of the Kamehameha Schools, Bishop Estate. This is the Hawaiian institution, I believe, you were referring to in your questioning of Mr. Woodward.

Chairman STARK. Yes.

Mr. TAKABUKI. I would like to say at the outset regarding the questions you posed relative to seller financing and restricting all taxable partnerships to organizations or just tax exempt organizations, we would have no objection to these two restrictions that are in the Senate measure.

I do not fully understand what you are referring to in terms of donated property, but I am sure that we would have no objections to that.

Chairman STARK. There are many times where private investors have invested through limited partnerships and taken tremendous tax shelters out of the front end. Let us say it is a 10-year ownership period. In the first 5 years, they have gotten much more than their investment out.

Mr. TAKABUKI. There is a cross-over in the cash flow, yes.

Chairman STARK. At that point, if they could get a high appraisal and donate, they not only would escape the recapture in the later years, but they would get an additional tax deduction.

The Treasury sees that as a way to game or to unwind some of these provisions and did not want to make them——

Mr. TAKABUKI. I would have no objections to that measure, except I cannot see how this ties in with the debt financed real property as we have under H.R. 676.

Chairman STARK. Well, but you are accepting that. You would be taking that property from them, accepting a donation subject to seller financing. I mean, it is all bound into the same objection.

Mr. TAKABUKI. Mr. Chairman, may I just briefly generally summarize how H.R. 676, applicable to debt-financed real estate, affects the Kamehameha Schools/Bishop Estate.

In our case, the endowment for Kamehameha Schools/Bishop Estate is primarily land, and without the debt financing allowed under H.R. 676, we will not be able to redevelop much of our income-producing urban land as quickly as we wish.

With its adoption, however, allowing us to debt finance in real estate, it will provide us with a vehicle to accelerate the funding necessary for our redevelopment program in certain urban areas. It will permit us to generate the kind of additional income we need to expand our program for the children of Hawaii and particularly, the native Hawaiian children there.

We believe the adoption of H.R. 676 will have a significant long-term impact on the educational mission of Kamehameha Schools/Bishop Estate, and for these reasons—I have other reasons, I am just trying to very briefly summarize it in the interest of time—we urge this subcommittee to approve H.R. 676 as amended by the restrictions proposed by the Treasury Department.

[The prepared statement follows:]

STATEMENT OF MATSUO TAKABUKI, TRUSTEE, KAMEHAMEHA SCHOOLS/BERNICE P. BISHOP ESTATE, HONOLULU, HAWAII

SUMMARY

1. H.R. 676 would amend the Internal Revenue Code to permit qualified tax-exempt educational organizations to borrow money for the purpose of acquiring or improving real property without being subject to the tax on unrelated business taxable income on income derived from real property.

2. The provision of law (Section 514(c)) which treats income derived from debt-financed property as unrelated business taxable income was originally enacted in 1950 and broadened by the Tax Reform Act of 1969 to prevent the abusive use of tax-exempt status in the acquisition of debt-financed property (i.e., so-called "sham transactions").

3. H.R. 676 contains a series of precisely worded safeguards to prevent the abusive use of tax-exemption in the case of debt-financed real property.

4. Based on the safeguards provided and Congressional approval of a provision permitting qualified pension trusts to invest in debt-financed property without being subject to the tax on unrelated business taxable income on income derived from real property it is entirely appropriate to extend such treatment to qualified educational organizations as provided in H.R. 676.

STATEMENT

Mr. Chairman, I am pleased to be here today and wish to thank you for scheduling this hearing on H.R. 676. My name is Matsuo Takabuki. I am a trustee of the Kamehameha Schools/Bernice P. Bishop Estate, Honolulu, Hawaii. The Kamehameha Schools were established under the Last Will and Testament of Princess Bernice Pauahi Bishop, the great-granddaughter of King Kamehameha I. The trustees of her estate were instructed "to erect and maintain in the Hawaiian Islands two schools . . . one for boys and one for girls, to be known as . . . The Kamehameha Schools." The Schools were to provide for the education of native Hawaiian children. The Schools were first opened in 1887 and have been in continuous operation since that date. The legacy to provide for the operation of the Schools were the lands owned by the Princess at the time of her death. These lands represent approximately 10 percent of the land area of the state of Hawaii. Approximately 2 percent of these lands provide most of the revenues for the operation of the Schools. The remaining 98 percent of the lands are used for agriculture, conservation, and watershed.

I am here today to testify in support of H.R. 676 sponsored by Congressman Shannon, Martin (North Carolina), Gephardt, Frenzel, Heftel, Vander Jagt, Fowler, Downey, Matsui and 25 other members of the House of Representatives.

H.R. 676 would amend the Internal Revenue Code to permit tax-exempt educational organizations to borrow money for the purpose of acquiring or improving real property without having to treat the passive rental income from such property or from sale as unrelated business income subject to tax. Under present law if a tax-exempt educational organization invests in debt-financed property, all or a portion of the income derived from such property is subject to the tax on unrelated business income.

The provision of law (§ 514(c)) requiring the taxation of such income was originally enacted in 1950. It was broadened by the Tax Reform Act of 1969. Both the original legislation as well as the 1969 amendments were designed to discourage certain abuses of tax-exempt status. Specifically, the 1969 legislation was intended to prevent sham transactions in which taxable organizations sold assets to a tax-exempt organization at an inflated price and then the assets were leased back to the seller. The earnings of the business were used by the seller to meet scheduled rental payments. The tax-exempt organization then returned these funds to the seller as payment for the assets "purchased." In this way, the seller (1) deducted the rental payments as a business expense and (2) upon receipt of purchase payments from the tax-exempt organization, treated them as capital gain. This type of arrangement permitted a taxable corporation to convert ordinary income into capital gain and permitted the tax-exempt organization to eventually acquire assets without any out-of-pocket cost.

H.R. 676 contains a number of precisely worded safeguards to prevent the pre-1969 abuses from recurring. H.R. 676 would tax-exempt educational organizations, if the safeguard requirements are complied with, to finance real property acquistions and improvements without being subject to the tax on unrelated business income on the income derived from real property.

Today, more than ever before, many educational organizations are facing a tremendous shortage of funds. This is a result of many factors, not the least of which are the state or our economy and the cutback of many Federal programs. H.R. 676 provides a means whereby tax-exempt educational organizations can attempt to meet their own funding needs while still providing protection against the abuses which have occurred in the past.

In considering this legislation, it is important to note that the holding and improvement of real estate for the purpose of deriving rental income is not considered in unrelated trade or business for tax-exempt educational organizations. Rental income is generally not taxable as unrelated business income for organizations which are exempt from taxation under section 501(c)(3) of the Code. The major exception to this rule is for real property financed through borrowing. Apparently, the concern is not with the ownership of real estate, per se, but with potential abuses that may occur when property is financed throurh borrowing. H.R. 676 provides safeguards to avoid past abuses. It also permits debt financing for real property acquisitions and improvements which are otherwise acceptable activities. I respectfully sumbit that H.R. 676 strikes the necessary balance between the need of educational organizations to finance their legitimate activities, and the need to the public to be protected against abuses use of the tax laws.

It should also be noted that this legislation will promote more balance investment portfolios for tax-exempt educational organizations. We are all aware that prudent investment calls for diversification of an investment portfolio. This is especially true for fiduciaries of tax-exempt organization. An important element in any diversified portfolio is investment in real estate. However, current law severely restricts investment in real estate by tax-exempt educational organizations. Such investment require a very substantial proportion of assets to be committed to real estate. If money is borrowed, the return on investment is decreased because a portion of the rents received will become taxable as unrelated business income. Enactment of H.R. 676 would correct this problem. It would permit tax-exempt educational organizations to invest a prudent portion of their portfolio in productive real estate investments.

In the case of the Kamehameha Schools the potential imposition of this tax impedes our effort to fund a broad range of educational services to the children of Hawaii. We simply must defer or not undertake many important programs because our income cannot be increased quickly enough through more rapid development of our income producing properties. We are unable to totally finance all of the development projects we could be undertaking to generate the income needed for the expansion of our educational programs without debt financing as permitted under H.R. 676.

In Public Law 96-605, enacted in 1980, qualified retirement trusts were provided with the opportunity to invest in debt-financed property without being subject to the tax on unrelated business income on the income derived from real property. The safeguards contained in H.R. 676 are identical to the safeguards currently in effect with respect to qualified retirement trusts.

Finally I am pleased to be able to advise the Subcommittee that the substance of a companion bill, S. 1183, has been included in the Senate Finance Committee's Deficit Reduction Act of 1984, approved March 21, 1984. The Committee has added certain additional restrictions to our proposed bill at the urging of the Treasury Department and we fully support the measure, as modified. A copy of the provision and explanatory materials are attached for your convenience.

In conclusion, I urge this Subcommittee and the full Ways and Means Committee to act favorably on H.R. 676 to permit tax-exempt educational organizations to better provide educational opportunities to our nation's young people.

Chairman STARK. Thank you very much.

I must point out, as I am sure Mr. Takabuki knows, that one of the primary sponsors of H.R. 676 is Congressman Heftel who, because of a very unfortunate auto accident, is still going through extensive physical therapy.

But his staff was in touch with me yesterday and I assure you, he is working diligently to see that this problem is resolved for what he considers a premier educational institution in his Home State.

Mr. TAKABUKI. We are aware of that, Mr. Chairman, and we certainly appreciate the efforts of our Congressman from Hawaii, Cecil Heftel.

Mr. STORRS. Mr. Chairman, before we move on to the next member, can I make one comment?

Chairman STARK. Sure.

Mr. STORRS. Because I thought there was something that was a little unclear.

A gift of a partnership interest to a university of a—call it a burned-out tax shelter—I believe will already be restricted under the first of the two Treasury suggestions that all of the partners be tax exempt entities.

So, if it were a typical syndicated partnership with most of the people who bought it being tax shelter purchasers, a gift of that interest to a university would already be handled without any third requirement.

I would distinguish that, sir, from a gift of which we receive many, for instance, of a home with an existing mortgage on it. We would think that would not come under the category of abuses of the type the Treasury is concerned with.

So, I would wonder if we need to make a third special distinction with respect to gifts of leveraged property because that is already handled under the rule that all partners must be tax exempt entities.

Chairman Stark. I can see, Mr. Storrs, no objection to that type of situation. I do not see any abuse or prospect for abuse. I think that has been the concern.

Mr. Steil, are you next?

Mr. Steil. Yes, Mr. Chairman.

Chairman Stark. In reviewing your prepared testimony, I will have to ask you to confine your testimony to H.R. 676. You made reference in here to H.R. 4075 which has not been referred to this committee and, under the rules under which this subcommittee operates, that testimony would not be in order at this time.

So, if you could confine your remarks to H.R. 676 the Chair would appreciate it.

Mr. Merritt. May I say something, Mr. Chairman?

Chairman Stark. Please.

Mr. Merritt. I am James Merritt, I am a partner with Morrison & Foster, a law firm here in town.

I had understood when we submitted our request to speak, to testify, that we would be able to encompass the modifications to H.R. 676 envisioned by H.R. 4075.

Chairman Stark. I am sorry—and I would be glad at the conclusion of the hearing, but I am sure for those of you who are familiar with the legislative process here, that we cannot, for a variety of reasons, bring up other bills that would give even the remotest hint of our having had a hearing on them, without noticing other members and without that bill having been referred to the subcommittee.

So, I would have to ask you, as I said, to confine your remarks to H.R. 676.

Mr. Merritt. We will be happy to comply with your request.

Chairman Stark. Thank you. Without objection, your testimony, absent those portions which refer to H.R. 4075, will be made a part of the record in its entirety.

Mr. Merritt. Thank you.

I would like to introduce Mr. Peter Steil. Mr. Steil is a principal with the RREEF Fund and he has in excess of 15 years experience in the management of real estate both with the RREEF Fund and, prior to that, with Morgan Stanley Co.

STATEMENT OF PETER STEIL, PRINCIPAL, RREEF FUNDS, ACCOMPANIED BY JAMES E. MERRITT, COUNSEL

Mr. STEIL. Mr. Chairman by way of introduction, the RREEF Funds are the largest group of closed and tax exempt real estate investment funds in the United States with over $2 billion under management at this time.

We fully support H.R. 676 to permit tax exempt educational institutions to invest in debt financed real property without incurring the tax on unrelated business income which would otherwise be payable.

In our experience, commitments to such real property are made as investments, not as operating businesses. They are presently taxed, as you know, when owned by educational institutions but not when owned by certain other exempt organizations, namely pension trusts and other government plans.

H.R. 676 begins to treat the inequities which exist for educational institutions but, as you are well aware and as discussed more broadly in my prepared remarks, there are a series of inequities which do in fact exist that crop up throughout the process, and to the extent that in conference many of these inequities can be resolved, we obviously will further support that.

I would go on to observe that contrary to Treasury estimates, we do not believe that any changes incorporated in H.R. 676 would result in any revenue loss to the Treasury since it would simply open up a new market for investment that would otherwise have been made in a different tax exempt manner.

In the context of the issues that you have addressed directly with Bob Woodward and then asked us to focus on, I think that to the extent that we would incorporate in a bill a prohibition on seller financing, we would agree that a restriction which would limit the abuses in this regard is absolutely important. But we would strongly recommend that this restriction be modified as it appears in the Senate bill, only to prohibit seller financing with a term of more than 3 years.

This would still allow investors to purchase property on a legitimate installment basis.

We definitely concur with the prospective provision that all partners in such an entity be tax exempt. We agree that would reduce the prospect of potential abuse and further, it would reduce the potential for conflict amongst different types of investors in the same ownership entity. We consider this, H.R. 676, to be from our experience a very important provision where in recent years the lack of any acceptable investment vehicle has forced RREEF to advise numerous organizations that we could not assist them in making prudent real estate investments.

These organizations include the Ford Foundation, the Rockefeller Foundation, the Mellon Foundation, the Kamehameha School and others, and in that context, while we are focusing here just on educational institutions, as you are aware, the inconsistency in the law applies to other charitable foundations.

I think with that, to the extent you have questions, I would be prepared to answer them. But that concludes the remarks that I have at this time.

[The prepared statement follows:]

Statement of Peter Steil, Principal, The RREEF Funds

Mr. Chairman and Members of the Subcommittee: I am pleased to have this opportunity to present the views of The RREEF Funds in support of H.R. 676. H.R. 676 will permit tax-exempt educational institutions to invest in debt-financed real property. This extends the exemption from the tax on unrelated business income derived from debt-financed property now enjoyed by certain other exempt organizations. We support this extension but urge you to include other tax-exempt institutions as is proposed in H.R. 4075 sponsored by Representative Matsui. Indeed The Senate Finance Committee has combined these proposals and included governmental funds in its bill, the Deficit Reduction Act of 1984, Section 865.

The RREEF Funds are the largest group of closed-end, tax-exempt real estate investment funds in the United States. Since 1975, The RREEF Funds have provided an opportunity for exempt organizations, principally pension funds and government plans, to invest in a series of professionally managed, commingled, closed-end real estate investment funds. At this time, The RREEF Funds have over $2 billion under management for exempt organizations, earning a return on investment which enables these organizations to carry out their exempt purposes.

It is essential as a matter of public policy that tax-exempt institutions with equally worthy missions be treated fairly and in a nondiscriminatory fashion. These institutions must be permitted to easily diversify their investments so that they can minimize the risk of asset erosion which so plagued these institutions in the 70's.

Present law not only treats tax-exempt institutions with equally compelling claims for government policy approval differently, but it does so in an arbitrary and capricious fashion amounting to a crazy quilt pattern of regulation that extends the old adage—the life of the law is experience rather than logic—to new indefensible ground.

Mr. Chairman, we come before your committee to support this bill, H.R. 676, because it would take one step toward correcting present inequities. It would extend to educational institutions the exemption from the unrelated business income tax on debt-financed property currently extended to pension trusts and government plans, thereby correcting the unfair treatment of such investments by educational organizations. Should it pass, H.R. 676 would result in no revenue loss to the Treasury since it would simply open up a new market for investments that would have otherwise been made in a different tax-exempt manner.

H.R. 676 however, represents only small progress toward eliminating the inequities and inconsistencies in current tax law affecting exempt organizations. While RREEF supports H.R. 676, we would urge the Committee to improve this legislation by incorporating provisions contained in bills introduced by Represenative Matsui (H.R. 4075) and Senator Packwood (S. 1815). The Senate Finance Committee has approved S. 1815, and it is presently Section 865 of the Deficit Reduction Act of 1984 that has been reported by the Senate Finance Committee.

In brief, therefore, we support amending H.R. 676 to alleviate additional inequities and further facilitate the ability of tax-exempt organizations to diversify their investments. Representative Matsui's bill (H.R. 4075) would accomplish this goal neatly by adding a new section, 501(c)(24), to the Internal Revenue Code that would provide exemption from taxation for a corporation that has as shareholders only other tax-exempt organizations of the type that generally invest in real property, and that limits its (the corporation's) activities to the acquisition and management of real property. Different kinds of exempt organizations—for example, a pension trust, a public charity and a university—could be shareholders in the same 501(c)(24) corporation, thereby enabling those organizations to diversify their real estate investments in a common vehicle. The bill would expand the unrelated business income tax-exemption features of H.R. 676, now limited to educational institutions, to include exempt organizations such as foundations and charities that equally deserve the right to be treated fairly with respect to investments in debt-financed real property.

BACKGROUND—WHY H.R. 676 AND RELATED IMPROVEMENTS ARE NECESSARY

Before 1977, Section 501(c)(2) corporations were useful vehicles for a group of tax-exempt organizations to invest in real property. Section 501(c)(2) exempts:

> Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section.

Both tax-exempt entities such as organizations described in Section 501(c) and 501(d) and pension plans described in Section 401(a) were at that time eligible to invest in 501(c)(2) corporations. Tax-exempt entities could invest in such a corporation simply by purchasing its shares of stock, an obviously convenient and comfortable mode of investment for tax-exempt institutions. Since multiple tax-exempt entities of different types (e.g., pension plans and charitable foundations) could purchase shares in the same corporation, this device afforded tax-exempt entities an opportunity to diversify their investment portfolios by investing in real property. Utilization of a Section 501(c)(2) corporation was approved in at least two instances by the National Office of the Internal Revenue Service.

In 1977, however, the IRS reversed its earlier position and concluded that a Section 501(c)(2) corporation could not be owned by "unrelated" tax-exempt entities. Moreover, the IRS stated that a Section 501(c)(2) corporation could not be sponsored by investment advisers (organizing the investment fund was deemed too "commercial"), but rather had to be established by a tax-exempt entity itself.

Another vehicle through which tax-exempt organizations have invested in real property is the group trust—an entity described nowhere in the Internal Revenue Code, but "created" in Revenue Ruling 56-267, which sets forth the requirement for the group trust. In effect, a group trust is a pension trust described in Section 401(a) which can have a beneficiaries only other pension trusts. Group trusts are exempt from federal income taxation pursuant to the provisions of Revenue Ruling 81-100. The IRS did not and does not express any concern that the group trust, as opposed to a 501(c)(2) corporation, would have multiple beneficiaries, or that investment in it would be commercially solicited. Indeed, the National Office also issued a ruling extending tax-exempt status to a Section 501(c)(2) corporation *wholly-owned by a group trust.* The National Office based this ruling on the grounds that ownership of the corporation by the group trust avoided the IRS's two stated concerns, because the corporation would not have multiple parents, and shares in the corporation would not be marketed (notwithstanding the existence of *multiple* group trust beneficiaries, or the fact that investment in the group trust itself might have been commercially solicited).

Unfortunately, there are two primary shortcomings to the group trust as an investment vehicle for tax-exempt entities. The first is the limitation on eligible investors in the group trust. Educational endowments, foundations, and similar exempt organizations cannot currently invest in group trusts. Secondly, under the laws of many states the owners of the trust may be personally liable for the obligations of the trust and limited liability is of particular importance to the typical tax-exempt institution.

Another inconsistency concerning these investment vehicles centers on transactions involving debt-financed property. In 1980, Congress added Section 514(c)(9) to the Code, permitting a "qualified trust," which is any trust described in Section 401(a) (*i.e.*, pension funds including group trusts), to acquire real estate subject to leverage without becoming liable for any unrelated business income tax. Previously, a portion of the income generated by leveraged property had been taxable. This section solved the problem faced by group trusts when they acquired property subject to existing debt at favorable rates or debt which could not be paid off without a significant prepayment penalty. For no reason except the evolution of decisions in this area, however, the benefits of Section 514(c)(9), apply to group trusts but not to the group trust's Section 501(c)(2) subsidiary corporation. This inconsistency makes it impossible under current law to achieve simultaneously the protection of limited liability and the treatment granted by Section 514(c)(9).

Legislation such as H.R. 676 is needed to eliminate this inconsistency and extend the debt-financed property exemption uniformly to all tax-exempt organizations. It is simply unfair to discriminate against organizations such as educational institutions, foundations, and public charities by denying them the tax treatment currently extended to other organizations such as pension trusts.

Such discrimination seems particularly inexplicable at a time when budget pressures force Federal and state governments and the American people to depend even more on these institutions. The Treasury opposed the 1980 legislation providing unrelated business income tax relief to pension plans. Treasury has, however, agreed to accept the creation of 501(c)(24) corporations which will include any 501(c)(3) tax-exempt organization and government funds in the Senate bill.

Enactment of H.R. 676, improved by the provisions of H.R. 4075, is necessary to resolve the inconsistencies in present law and to provide an opportunity for exempt organizations smaller than pension funds to make prudent real estate investments. Only through such legislation can this purpose be achieved. Amounts which a smaller organization can afford to invest are not sufficient to enable it to realize any breath in its real estate investment portfolio unless its funds are combined with those of other organizations. Thus, unless these organizations can combine their investment with those of exempt organizations with larger amounts to invest, such as pension trusts, any real estate investment by these smaller organizations is difficult, and responsible diversification of that investment is impossible.

The two reforms: (1) extending the unrelated business income tax exemption; and (2) allowing joint investments in a corporate vehicle (a 501(c)(24) entity) are closely connected and should be addressed together in the consideration of H.R. 676. Indeed, educational institutions and foundations should be treated the same as pension trusts for unrelated business income tax purposes in order to avoid a conflict of interest within such a joint investment corporation. In other words if a "pass through" of tax treatment of income were to occur, so that some shareholders in the corporation (the pension trusts and government plans) were exempt from the unrelated business income tax, and the other shareholders were not exempt, then the shareholders would have conflicting interests whenever an opportunity arose to acquire a property with a pre-existing mortgage at a favorable rate. To facilitate investments by smaller exempt organizations it is necessary, therefore, not only to create a Section 501(c)(24) corporation, but also to extend to that corporation the exemption from the tax on unrelated business income from debt financed property.

In addressing the provisions of the Matsui-Packwood bills, the Treasury Department has expressed concern that the shareholders—the exempt institutions—not lose control over the funds entrusted to an investment adviser such as RREEF. RREEF shares that concern and, indeed, its investors have the ability to terminate the contract with the investment adviser by a direct vote of 60% of the group trust beneficiaries. Individual investors may also withdraw their funds upon 90 days notice to RREEF subject to certain restrictions. We are proud of the fact that no beneficiary has ever suggested a vote to terminate a contract with RREEF, and we feel these safeguards demonstrate to potential investors our confidence and experience in this field.

To address its concern over shareholder control, the Treasury Department has recommended that the officers and directors of the Section 501(c)(24) corporate investment vehicle not be officers or directors of the investment adviser. Such a restriction is currently in the Senate bill (§ 865(b) which adds a new subsection 501(c)(24)(A)(ii) to the Code). While RREEF agrees with Treasury's substantive goal, requiring a board of directors "independent" of the investment adviser is not the only method nor, indeed, the best method of accomplishing the objective of retaining control by the tax-exempt organizations.

The requirement of an "independent" board would inject a completely superfluous third party into the relationship between the shareholders and the investment adviser of their choice. It would be difficult to find people willing to serve on such a board, since the board's power would essentially be limited to firing an incompetent investment adviser; moreover, because of such limited power in the board, it would probably be quite expensive to convince people to serve. And if the board had authority to oversee specific investment decisions, it would defeat the entire purpose of the shareholders who are seeking to entrust decisions regarding their funds to an experienced and capable investment adviser.

What is sought by Treasury is to ensure shareholder control; what is recommended by Treasury is overly broad and self-defeating. A more precise and feasible solution would be to require that the shareholders of such a corporate vehicle be able to remove the investment adviser by majority vote. RREEF would strongly support such a requirment. In fact, it should be noted that the shareholders under any circumstances have the power to vote directors of their choice—either themselves, disinterested parties, or the investment adviser's officials—as they see fit. Requiring an "independent" board would create a cumbersome and costly mechanism without concomitant benefits and undermine the purpose of the legislation. An independent board might be required where there are many shareholders who are not experienced or sophisticated. If, however, there are fewer than 50 shareholders or if each shareholder invests at least $1 million or has a net worth of $25 million it should be equally satisfactory to permit such shareholders to directly control the investment adviser by majority vote without creating an additional layer of management (an independent board). In any event some members of the investment adviser should serve on the board. We would recommend that at least one-half the board be permitted to be composed of officers or directors or partners of the investment adviser.

The Senate bill also prohibits the officers of a 501(c)(24) organization from providing investment advice. This would interfere with the day to day operations of the organization and would not ensure control by the shareholders. Contracts must be signed, payments received, expenses paid and income distributed. Normally the investment adviser performs these services and there is no need to require the 501(c)(24) organization to employ other persons as officers to perform these services. Such restrictions are not required of similar advisers under the Investment Company Act of 1940 and should not be included in the statute.

The Senate bill also prohibits any seller financing of real property under Section 514(c)(9). In general, we agree that a restriction upon seller financing will prevent abuses. It will, however, prevent some purchases of real property on a short term installment basis which do not involve any abuses. We strongly recommend that this restriction be modified to prohibit seller financing of real property with a term in excess of three years. Short-term installment debt to the seller does not involve an abuse whether the debt is recourse or nonrecourse and will permit investors to purchase on a legitimate installment basis.

No currently existing investment vehicle satisfies the need which would be filled by enhancing H.R. 676 to encompass the 501(c)(24) corporation that would be established by the Matsui bill (H.R. 4075) and Section 865 of the Senate bill. For example, the investment needs of exempt organizations cannot be satisfied by use of a limited partnership. In order to have a valid limited partnership, at least one investor would be forced to act as the general partner, subject to complete liability for partnership obligations which could not be limited to its investment in the partnership. Furthermore, if a corporation or investment adviser was to act as general partner, the standards set by the Internal Revenue Service for issuing a ruling as to the partnership's validity would require maintenance of a net worth and investment in the partnership of a size which is generally beyond the capabilities of any single investment adviser or exempt organization.

In recent years, the lack of any acceptable investment vehicle has forced RREEF to advise numerous organizations that RREEF could not assist them in making prudent real estate investments. These organizations include the Ford Foundation, the Rockefeller Foundation, the Mellon Foundation, the J. Paul Getty Foundation, the Murdock Foundation of Oregon, and the Kamehameha Schools of Hawaii. While H.R. 676 would remove one obstacle to real estate investments by large educational institutions, it would not provide opportunities to tax-exempt institutions—large and small—to take advantage of the expertise and experience that RREEF has developed over the years and which attracts numerous inquiries about investment advice. We understand that the need for this more extensive legislation has prompted support for H.R. 4075 from the National Association of Independent Colleges and Universities and the Council on Foundations.

We support H.R. 676 as a step in the right direction. We submit, however, that additions are needed to correct the inequities that H.R. 676 begins to address. We therefore urge the Committee to add the provisions of H.R. 4075 so as to resolve, in one piece of legislation, the inequities and inconsistencies that exist in current law regarding exempt organization investment in real property. This may be accomplished by supporting the Senate bill which incorporates both H.R. 676 and H.R. 4075. The restrictions of that bill upon officers and directors of the new 501(c)(24) organization should be modified and short-term seller financing should be permitted.

This concludes my prepared remarks. I would be happy to answer your questions.

Chairman STARK. Mr. Steil, would you support my bill to make all real estate income tax free?

Mr. STEIL. To make all real estate income tax free?

Chairman STARK. Yes, just exempt it. For everybody.

Mr. STEIL. Certainly, that is something that we could support. However, it seems to me that the tax incentives that are there have had specific objectives that might, you know——

Chairman STARK. Do you know what the net result of all those objectives was in 1982?

Mr. STEIL. No.

Chairman STARK. The total rental income reported on all personal income tax returns was a negative $8 billion. That is the net rental income.

So, when we talk about incentives, they are quite adequate.

Mr. STEIL. It would seem that way.

Chairman **Stark**. It is an interesting way of pointing out the box we have gotten ourselves into by all of the various kinds of special incentives we give to real estate and probably as a net result of lowering the overall yield to all of you because I think it has bid up prices in a strange way. For example, when the cap rates dropped measurably below what could reasonably be expected to be even variable rates for permanent real estate financing, something seems somewhat out of kilter. That may be the reason for it. We have now passed the limits of my understanding of the economics of this whole thing.

I want to thank all of you and assure you that your continued cooperation, particularly if we can find a way in the next several weeks to accommodate the very real concerns of the educational institutions, the chair—just as an aside—has always felt that real estate investments have to come into their own. They are in many cases much more attractive for prudent trustees.

To the extent that we can achieve that objective without putting that negative figure any further down than it already is, we will try to do that.

I appreciate your taking the time to testify today, and I also appreciate your watching me eat lunch and the numerous interruptions that have been necessitated by our activities on the floor.

Thank you very much.

Mr. **Storrs**. Thank you.

Mr. **Farrell**. Thank you.

Chairman **Stark**. If the panel interested in H.R. 2697—Mr. Joseph Miller of the American Legion and Ms. Sandra Crawford, chairman of the public policy committee of the Association of Junior Leagues—would like to come to the witness table.

Congresswoman Mikulski is on her way, and if the panel will not mind we will proceed, and when Ms. Mikulski arrives, we will interrupt—if you will not mind—which is our traditional policy here, and let her present her testimony and then go on.

So, once you are comfortably seated, we will proceed, if it is all right with you, in the order of the witness list, and that would have Mr. Miller testify first.

You may proceed, Mr. Miller, in any fashion that you are comfortable. I would ask the staff to keep their eye open for Congresswoman Mikulski and let us get her to the witness table upon her arrival.

Please, proceed.

STATEMENT OF JOSEPH E. MILLER, JR., ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION

Mr. **Miller**. Thank you, Mr. Chairman.

We would like to thank you and the members of this subcommittee for allowing us to appear before you today on several bills that would increase the volunteer mileage deduction.

Chairman **Stark**. If I could interrupt. Were you both here when the Treasury testified this morning?

Mr. **Miller**. Yes, sir; I was.

Chairman **Stark**. To the extent that you can deal with the Treasury Department's concern about the fact that the volunteer would own the car anyway and therefore we should limit the deductions to, in a sense, gas and oil, it would help the Chair in whatever compromise we may have to work out with the Senate.

I am sorry for the interruption. Proceed.

Mr. MILLER. Let me state from the outset, Mr. Chairman, that we address each of the Treasury's arguments, that is, their primary arguments, within our prepared statement.

Chairman STARK. Thank you.

Mr. MILLER. We address each of the Treasury's arguments within our prepared statement, and would like to ask the subcommittee to take a look at those, and we will address some of them here for you this afternoon.

Mr. Chairman, we wish to ask that several documents be entered into the record of these proceedings. I would like to introduce two letters that were received by the American Legion's legislative division regarding the volunteer mileage issue from people in the field who actually perform volunteer services.

I would also like to introduce two documents which are brief historical synopses of the American Legion and the American Legion Auxiliary and which basically detail our organization's commitment to volunteerism and its mission to help people.

Chairman STARK. Without objection, those will be made part of your testimony.

Mr. MILLER. I would also like to introduce for the record copies of the 1983 Consolidated Post Reports National Summary, as well as the 1983 Consolidated Post Reports National Summary which detail the amount of money and the number of hours spent by American Legion posts across the country in pursuit of volunteer activities.

I would also like to bring the subcommittee's attention to that in both cases, these national summaries represent approximately 45 to 46 percent of all posts reporting. Therefore, some of the figures shown on the summaries may even be double what they are in this report.

Chairman STARK. As a recipient of the American Legion's generosity as a member of the National Boys Forum long before you were born—an act which the American Legion has regretted ever since but for which I have been deeply grateful—I fully appreciate their interest.

I am going to ask Ms. Mikulski to sit right here. Do you want to wait a minute, or do you want to come on right away? This is your bill that we are hearing testimony on.

If we could interrupt, could we hear from Congresswoman Mikulski?

Mr. MILLER. Please.

Chairman STARK. Barbara, welcome to the committee, and we are hearing now testimony on your bill, H.R. 2697, which has numerous cosponsors.

We had asked the witnesses to let you interrupt because we know of your busy schedule. The Treasury, if I can summarize for you just a moment, opposed this bill this morning in their testimony based on the theory I am sure you have heard, that people own the car anyway, therefore the oil and gas is really all they ought to get.

We will make your complete testimony a part of the record, and any additional material you care to submit. You might care to talk to that particular Treasury point because I think if we could overcome that, we are half-way down the line to getting unanimous consent.

STATEMENT OF HON. BARBARA A. MIKULSKI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Ms. MIKULSKI. Thank you, Mr. Chairman. I thank our colleagues on this legislation for yielding my time, they are constituents with the Easter Seal Program who are waiting who are also much in need of both help and any support that we could give our volunteers.

I do ask unanimous consent that my entire statement be read.

Chairman STARK. Without objection.

Ms. MIKULSKI. Mr. Chairman, the volunteers are really a major labor force in the United States. When we take a look at the Candy Stripers, the Scout leaders, the Veterans, the Junior League, they contribute over $111 billion to the Nation measured in terms of both time and actual services.

Now, when a volunteer uses his or her car, whether it is to provide transportation for those individuals who have cancer and are in need of chemotherapy, to the people who deliver Meals on Wheels, to those Veterans who use their car making sure that Veterans get to medical and social services that they need, the use of their car has become far more costly.

During the pre-OPEC days, one could afford to be a volunteer. However, as the cost of oil, gas, and others have skyrocketed; where gas was once 40 cents a gallon, Mr. Chairman, as you know, it is $1.40 a gallon and many volunteers, particularly the older volunteers, are on a very fixed income themselves.

What immediately comes to my mind is those people who deliver the Meals on Wheels and also those people engaged in Veterans services, tend in many instances to be over 60 themselves. So, any assistance that we could give them would be of enormous help.

As you know, if volunteers did not provide this service, Government would have to provide this service at far more cost than this modest tax break, and yet would not combine the same compassion, I do not think.

If one takes a look at the Meals on Wheels Program, to which I am particularly devoted to, the average age of the volunteer, as I understand it, is over 60. And the people who need Meals on Wheels would need a Government service to get it. Either they would have to be institutionalized at horrendous cost to the Government or, if we wanted to prevent institutionalization, of which Meals on Wheels is an important component, we would have to go to catering.

Well, somehow or another, I would much rather rely on my Meals on Wheels volunteers than a caterer. So, it is not that if we did not do this that the Government would benefit. I think that the Government has benefited and I think that the business of this country is to provide good guy bonuses. You provide the good Samaritan bonuses. You recognize those people who give their time.

And they are not asking for some kind of compensation. They are not even asking for reimbursement.

They are just asking for us to cut the costs of being a volunteer. I think it is a very modest request in light of the tax breaks we have given oil companies; the tax breaks we have given chief executives, even though the legislation yesterday plugged up enormous loopholes.

So, that is the rebuttal that I would use.

[The prepared statement follows:]

STATEMENT OF HON. BARBARA A. MIKULSKI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Mr. Chairman, thank you very much for the opportunity to testify on behalf of my legislation, H.R. 2697, the "Volunteer Mileage Bill".

This bill raises the amount that a volunteer can deduct for the use of their automobile in volunteer work. Under my bill, the amount of the automobile deduction allowed for volunteers would be the same as the deduction for business uses—20¢, not 9¢, per mile.

Volunteers are a major labor force in the United States. Together, they contribute some $111 billion to this nation measured in time and services. They are the candy-stripers, the scout leaders, the civil rights activists, the veterans, the chamber of commerce members, the Kiwanis Club, the Blue-Chip-In participants, the meals on wheels bringers, the donaters and the telethoners.

But we cannot and should not measure the volunteers' contribution in time and money alone. We must also measure it in terms of the value system it represents—a sense of caring and a heartfelt motivation to make the world just a little bit better. Our volunteers are working at full capacity, selflessly and effectively. It is time that we return something to these tireless individuals.

With the tremendous losses in federal social programs, there is a new call to our volunteer community to step forward and fill the vacuum. Volunteers have been asked to substitute for the drug rehabilitation programs, the aid to the handicapped, the loss of CETA, and a host of other needed social programs. It's a tall order and the volunteers are going to need help.

We all seem to assume that volunteers are somehow immune to the societal pressures that affect businesses. There are tax credits for oil companies, and expense accounts for executives, but volunteers are somehow expected to be an endless reservoir of resources, money and energy.

Inflation has affected the non-profit world in the same way that it has affected government and profit-making organizations. Those ladies who work the auxiliary at the hospital are under pressure to contribute additional income to the family. That Boy Scout troop leader may be looking for a second job, or may have been laid off from our steel, housing, or auto industry. That meals on wheels volunteer may have to help out grandma because her Medicare costs have increased. In fact, many volunteers are on fixed incomes themselves. Times are just as tough for the volunteer as for the mega-corporation, yet we blithely expect the volunteers to give more and more.

Everyone has become more conscious of out-of-pocket expenses. Many volunteers have to travel miles and miles to do the good work they do—driving to meetings, to youth centers, to visit the housebound. Three milion of our volunteers are giving their resources to the federal government, working in parks, for the Veterans Administration, the Coast Guard Auxiliary. In turn, the federal government says, "Do more."

I can honestly say that I am not asking for special treatment for a privileged few, or a new loophole for some would-be tax evaders. I submit this testimony on behalf of the "good guys" of our society—men and women—who are out there every day helping their neighbors and ours. They have never asked for a reward; but now they are asking for equity. If it costs 20 cents a mile to operate a car for government purposes, it costs just as much to use it as a volunteer. And it is time that we recognize that economic reality of life.

All over the United States right now, volunteers using their own cars are providing essential services to their fellow citizens. In my own community of Baltimore in 1980, Meals on Wheels of central Maryland served 2,050 meals every day—driving 150,000 miles a week. Life Support Project volunteers visit elderly nursing home patients who would otherwise have no visitors. In 1980, they made over 6,500 visits to people in nursing homes. I know of two patients in cancer clinics who were driven to treatment 40 times for a total of 2,894 miles.

These are just some of the examples of the work done every day by volunteers, without salary, without payment—and too often without recognition of any kind. But now these programs are in trouble. The cost of gasoline is a serious threat to the kind of neighbor-helping society we Americans are so proud of. Every day, we learn or more programs which have had to cut back, to retrench, to deny services to needy clients—because they do not have enough drivers.

I do not want to lose the volunteer programs that are the bonding fabric in our society. I do not think we can afford to have this kind of work done by salaried employees. We cannot afford it financially—and we cannot afford it spiritually.

Finally, I am deeply concerned because the American people are now suffering under one of the largest cutbacks in government programs in our nation's history. Thousands of government programs providing essential services to millions of Americans have been eliminated. The need for charitable organizations and volunteers to fill this void is great. It is imperative that our government adjust its tax policy to encourage citizens to perform charitable works.

I urge this Committee to take action to keep volunteers in the programs and on the roads—pass H.R. 2697. Thank you.

MAJOR ENDORSERS OF VOLUNTEER MILEAGE BILL

United Way of America; Independent Sector; Boys Clubs of America; Goodwill Industries, American Hospital Association; League of Women Voters; VOLUNTEER; National Health Council; B'nai B'rith Women; Federation of Women's Clubs; Child Welfare League; Easter Seal Society; American Nurses Association; Childrens' Rights, Inc.; Travelers Aid Association; Council of Jewish Federations; American Legion; Girl Scouts, USA; American Cancer Society; Haddassah; National Mental Health Assoc.; Big Brothers, Big Sisters, Inc.; United Nations Assn. of America; American Lung Association; Amerian Jewish Congress; Young Women's Christian Assoc.; and Gray Panthers.

American Red Cross; National Conference of Catholic Charities; The Association of Junior League; National Council of Senior Citizens, National Meals on Wheels Assn., American Association of Retired Persons; National Council of Jewish Women; Volunteer Firefighters of America; National Youth Work Alliance; National Parents-Teachers Assn.; National Association for Hospital Development; Friends of the National Zoo; Veterans of Foreign Wars; Camp Fire Girls; Jewish War Veterans; National Fire Protection Assoc.; Joint Action in Community Service; Association for Volunteer Administrators; Women's Equity Action League; March of Dimes; Call for Action, Inc.; Marine Corps League, Inc.; and National Retinitis Pigmentosa Foundation, Inc.

Chairman **Stark**. I thank you. As you know, I am extremely sympathetic to this. As I said this morning, it is my constituency who will benefit from the volunteerism, not from the tax deduction. I am very sensitive to it.

We have one Meals on Wheels Program in a city in my district which is entirely supported by donations from the community. It receives no benefits or assistance under title 20, and we had some others which are federally assisted. They do provide some ray of sunshine to many people who would otherwise have their quality of life, I think, decline greatly.

I appreciate your concern. I can say for the record that I know that you have been a tenaceous and persistent advocate of this legislation and it is terribly frustrating, as we all know, to see bills proceed so slowly. I hope all the work you have done will result in the fruition of this legislation, that we may soon see it under the President's pen—certainly by this summer.

Ms. **Mikulski**. Thank you. Thank you.

I understand that the Senate has taken some modest steps in this direction.

Chairman **Stark**. I think they have given us 3 cents. As I recall, they go from 9 to 12 cents. They are headed in the right direction. I would suggest that you might spend some of your time on the Senate floor this afternoon pushing them a little further in this direction and we may have the grounds for a better compromise.

Ms. MIKULSKI. Thank you.

Chairman STARK. Thank you very much.

Mr. Miller, you were about to proceed, and if you would like to continue with your presentation.

Mr. MILLER. Thank you, Mr. Chairman.

Certainly, the American Legion respects and is proud to have cooperated over an extended period of time with Congresswoman Mikulski on the volunteer mileage legislation. She is certainly a tenaceous advocate of this bill, as you have been.

The Legion and other volunteer organizations are certainly appreciative of that.

If I may, I would like to summarize my statement very quickly and then I would like to respond to the Treasury's arguments.

The American Legion does support increases in the volunteer mileage tax deduction. We support parity. We also support H.R. 5357 which is Mr. Campbell's bill, to grant an immediate 3-cent increase up to 12 cents per mile. We feel that an inequity exists between the current rates allowed for volunteer mileage as well as the mileage allowed for business.

The Treasury's projected revenue losses which would result from the enactment of this legislation ignores the savings in outlays that would result from increased volunteer activity. The current volunteer mileage reduction represents approximately 33 percent to 38 percent of the actual per mile cost incurred in operating an automobile, depending upon the number of miles driven during the year.

The business mileage deduction represents 66 percent to 85 percent of the estimated actual cost of operating a private automobile.

During the last 25 years, the volunteer and business mileage deductions have increased by 23.6 percent and 128 percent respectively. During the same 25-year period, motor fuel has increased by 241 percent.

Volunteers are asking that they be reimbursed at the same level as persons who use their private automobiles for business. We feel that this is a fair as well as a reasonable request, Mr. Chairman.

Treasury's arguments against it that the volunteer already owns his automobile, as I just said, ignore the savings in outlays that result from volunteer activity. Congresswoman Mikulski just cited the value of volunteer goods and services. That figure, over the last three fiscal years, has steadily increased from $45 billion to $111 billion. That indicates that there is a tremendous outpouring of cooperative volunteer effort to help take up the shortfall that the American people see as necessary, in order to get the deficit under control.

Frankly, the Legion would question the IRS study cited by the Treasury, which indicates that 9 cents a mile is generous. We would have to disagree with that entirely.

We support Mr. Campbell's bill, 5357, and the Senate increase of 3 cents a mile, and we feel that it is a step in the right direction, we also feel that the correction of the inequity through the establishment of parity is the ultimate goal.

The fact that Treasury sat here today and talked about such things as abuse and the adequacy of the current mileage rate, is one of the primary reason why volunteers have had to go to Congress to seek this relief and why Congress must determine what the volunteer mileage rate will be.

Mr. Chairman, I will be happy to respond to any questions which you might have.

[The prepared statement follows:]

STATEMENT OF JOSEPH E. MILLER, JR., ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION

Mr. Chairman and Members of the Subcommittee on Select Revenue Measures, The American Legion is pleased to appear before you today to present its views in support of H.R. 2697, H.R. 3212 and, H.R. 358, proposed legislation that would amend the Internal Revenue Code of 1954 to increase the volunteer mileage deduction to the same level enjoyed by persons engaged in using privately owned vehicles (POV) for business activities. The American Legion, perhaps the nation's largest volunteer organization, strongly encourages the enactment of the proposals of Representatives Mikulski, Hammerschmidt and Roe to correct the inequitable treatment of volunteers who use their POV's for volunteer related activities.

Since the birth of our organization on March 17, 1919, The American Legion has been actively involved in this country's volunteer efforts. In fact, one of the primary goals of our initial meeting was to create, "a fraternity dedicated to the equitable treatment of all veterans, particularly the disabled, their widows and orphans". Six months later, meeting in St. Louis, The American Legion finalized its preamble preamble which concluded with the mission "to consecrate and sanctify our comradeship by our devotion to *mutual helpfulness*" (emphasis added).

Since those early days, the American Legion has expanded its volunteer activities to include athletic events (like Special Olympics), scholarship funds, blood donor programs and a multitude of community based volunteer activities too numerous to cite here. To illustrate our involvement, we would like to ask that several documents which explain Legion programs and activities be included for the record. In addition, we would like to submit for the record. In addition, we would like to submit for the record copies of the 1982 and 1983 Consolidated Posts Reports indicating the degree of involvement of American Legion Posts in volunteer programs and activities at the community level.

Today, there are 58 Departments and more than 16,000 American Legion Posts in this country and overseas. In addition, there are nearly 12,000 American Legion Auxiliary Units wordwide. Together, the Legion and its Auxiliary represent more than 3.6 million members who serve their communities and fellow Americans without pay. Our membership looks to the federal government to recognize their contributions and services and for equitable treatment. National Volunteer Week is but one way the government has recognized the achievement of volunteers. Many of our members also depend on the volunteer mileage tax deduction to defray a portion of the cost of providing their services to charitable activities.

The deduction volunteers take for miles driven is not compensation. Rather, it is to help offset the expense of operating an automobile which is being used to conduct volunteer activities. More importantly, however, it is the individuals who are helped by the Legion's, as well as other volunteer organization programs who are the real beneficiaries of the volunteer mileage tax deductions. As the cost involved in operating a POV continue to escalate, adequate reimbursement becomes even more critical to the support and maintenence of the charitable programs aiding Americans and communities in need.

Presently, an inequity exists that threatens to deny beneficiaries those services that they desperately need. The inequity that we are referring to is between the allowable milage rate tax deduction which can be taken by persons who use their automobiles to conduct charitable activities. To illustrate the burden facing the volunteer driver today we would like to submit for the record, copies of two letters received by the Legion's Legislative Division. Mr. Chairman, the correction of this inequity is long overdue. Given this state of the economy and the ever increasing reliance on volunteers to conduct programs once supported by the federal revenues, the perpetuation of a dual reimbursement rate can no longer be supported by arguments of revenues lost to Federal Treasury, enforceability or that the current mileage rate is adequate to cover the incremental costs directly attributable to the rendering of charitable services.

During early 1982 the U.S. Treasury was asked to estimate the revenue losses from a similar legislative proposal. At that time, the Treasury estimated that the loss in federal revenues from the enactment of such proposals would total $573 million between FY 82 and FY 87. According to the Treasury the loss per fiscal year could be broken down as follows: FY 82 at $7 million; FY 83 at $55 million; FY 84 at $102 million; FY 85 at $115 million; FY 86 at $135 million; and FY 87 at $159 million.

Clearly, something dramatic would have to be at work in order to account for these increases which gradually level out in Fiscal Years 84 through 87. There are several possibilities for the dramatic increases during the early fiscal years as estimated by the Treasury. First, there could be a substantial increase in the use of POV's for charitable purposes. Second, there could be a substantial increase in the use of POV's for charitable purposes and a corresponding increase in the number of individuals claiming the charitable mileage deduction. And third, the number of charitable miles driven annually might remain constant and thus the increased allowance will simply reflect the added cost per mile allowed as well as an increased number of people claiming the deduction. But, even the maximum anticipated revenue loss of $159 million during FY 87 would represent an investment of less than two one-hundredths of one percent of the total federal expenditures for that year, based on currect out year projections.

Assuming that the third possibility is representative of what will actually occur, then we are left with the perplexing problem of explaining the mammoth increases projected by the Treasury for FY 83, a rate which is double the projected increases for each of the remaining out years. Since, even non-itemizers are now permitted to claim a deduction for charitable mileage, the increase can not be attributed solely to an increase in the number of people claiming exemptions, unless there is a corresponding increase in the number of miles driven on behalf of charitable activities. If such is the case then the legislation being considered here today will have been successful in increasing the level of private sector volunteer participation which will, in turn, further decrease the demand for federal revenues. More importantly, however, is the added support of America's communities and citizens in need that the enactment of H.R. 2697 and the other bills will help to bring forth.

Another argument that has been advanced in opposition to the increase in the volunteer mileage deduction is that "of the difficulty in identifying and quantifying the amount of indirect costs in operating POV's for charitable purposes that are properly attributable to the charitable endeavors". The problem with this argument, as we see it, is that it assumes a difficulty that would not, in fact, be present since the volunteer mileage rate deduction would be tied to the business mileage deduction. Further, the terms identification and quantification imply some sort of rule making requirement on the part of the Treasury that would be difficult to develop. Yet, no such regulations would be necessary. Indeed, H.R. 2697 and the other bills would simplify the regulatory burden of the Treasury Department because there will be one rate and one formula to determine that rate. Likewise, arguments regarding "enforceability" are groundless unless it can be shown that volunteers are somewhat less honest than persons taking business related deductions for private automobile use. We doubt that such is the case since a 1981 survey by the Gallup Organization indicates that approximately 84 million Americans, 52 percent of the adult population, typically donate some part of their time as volunteers.

Moreover, arguments which argue current law, as opposed to arguments which examine the merits of the proposed change, are not really arguments but rather statements in support of the maintenance of the status quo. Frankly, Mr. Chairman, volunteers in the field feel that the disparity between the two automobile tax deductions indicates that Congress does not value the services of the men and women who support community based volunteer programs as much as it values the services of persons engaged in business activities. Clearly, the concerns expressed by volunteers in the field indicates that the status quo is counterproductive. Yet, despite the counterproductiveness of the dual tax deduction rates the Gallup study referred to earlier revealed that the estimated value of goods and services attributable to non-profit organizations during 1981 was nearly $64 billion. In 1980 another survey, by a different organization, estimated the value of non-profit services and products during that year at $45 billion. The magnitude of this increase, $20 billion in one year brings the contribution of the non-profit community into proper focus.

Because of this, The American Legion believes that the volunteer mileage tax deduction should be viewed as an "investment expenditure" rather than as a loss of federal revenues and which, when taken together with other investment expenditures, save the Federal government more than they cost. In fact, this system of tax benefits and expenditures warrants a closer look. If we take all of the tax benefits and expenditures for nonprofit activity during 1981 they would total nearly $21 billion. On the other hand, the estimated value of goods and services of volunteer activity during the same period has been estimated at $64 billion. If the Federal costs involved in assisting volunteer programs are subtracted from the total estimated value of goods and services there remains a substantial $43 billion in goods and services. In other words, for every dollar "invested" by the government in non-profit private sector activity, an additional two dollars in savings is being achieved. Volunteers and volunteer organizations have not been content with maintaining the status quo, indeed, they are actively seeking to increase their commitments to America's needy. But they need help.

Clearly, Mr. Chairman, non-profit organizations through the use of volunteers, including the Legion, have responded to the President's call for increased assistance to Americans in need from the private sector.

But, Mr. Chairman, let us look for a moment at the maintenance of the status quo. In 1957, the year prior to the institution of the volunteer mileage tax deduction, the average cost of a gallon of gasoline in the United States was $.31, and the allowable tax deduction wqas $.07 per mile. During 1983 the average cost of a gallon of gasoline was $1.27 and the allowable tax deduction is $.09 per mile.

Looking at these figures in another way, we see that during the last 25 years the allowable deduction for charitable POV use has increased by 28.6 percent. While, during the same period, motor fuel has increased by 241 percent. Likewise, in 1957, the allowable deduction represented 22.7 percent of the cost of a gallon of gasoline but by 1983 the allowable deduction represented only 7 percent of the cost of a gallon of gasoline.

Mr. Chairman, the volunteer community is simply asking the Congress to recognize that the expenses in operating a private automobile have risen disproportionately to the allowable volunteer mileage deduction and is asking for parity with persons, who, today, use their automobiles for commercial purposes. We believe that this is not only a fair request, but a responsible request as well.

Emerson, Ia

Dear Mr. Riggin,

I have been asked by Mrs Sylvia J. Klonis to write this letter to you.

I am President of the American Legion Auxiliary Unit 575 Emerson, Iowa and a volunteer.

This past year 1981, I put in 597¾ hr. Of volunteer work. driveing 4,924 mi. 126 hr. at the Veterans Hospital, Omaha, Neb. 405 hr. at the Glenwood State Hospital Scho. 61 hr. with the Iowa Special Olympics and the remaining hr. serving as hoste at the Nishna Valley School, Hastings Ia during National Education Week.

Our Legion Auxiliary is very small in numbers - 41 mem. 80% of these ladies Are in the 70-80 yr. Age range. So our money makeing projects Are few. And funds very low. They offered me $5.00 a month to help on Gas to drive to the V.A. Hosp. in Omaha. As of the first of the yr. I have refused the money because it leaves no money for them to help in other ways - The money will now go to An Organization each mo. Such as Childs Welfare, fund, Reye's Syndrome + Easter fund at the Glenwood State Hsp. School.

If President Reagan is serious about volunteers then he + Congress must help the volunteer in some way.

My husband is the Secondary Principal and Ath. Director at Nishna Valley Schools in Hastings, Iowa. At the present time our income alows me to do my volunteer work. But with the economy the way it is I may have to cut back. If I do it means 3 other volunteers wil also cut back because they depend on me for transportation.

My sugestion is, at least a 20¢ tax break for Mileage and possibly a $5.00 break for each 100 hrs. of Volunteer work.

In your letter to Mrs Klonis you mention Mileage Bills, H.R. 768 and S. 473. Can I get more information about these bills.

Sincerely Mrs Donald R. L.
Box 214
Emerson, Ia. 515

Charlotte A. Lee
Box 214
Emerson, Iowa
51533

[illegible]
1608 K St. N. W.
Washington, D. C. 2006

Important 28-F-81

Dear Phil:

Jim Bourie said you had requested that I should see if I could come up with some ideas of changes in the tax laws that might get more Volunteers.

The State of Ia. and Mills Co. in Ia. pays their help (like the Public Health Nurses) 22 cents a mile for using their own car, and the Government only allows 9 cents a mile for Volunteers. I think the Volunteers should be allowed the same amount for mileage as the paid employees. This to be in a tax credit and the Volunteer Hours verified. At the end of the year the Chief of Staff for the VAVS or the Activities Director at the State Schools could give the person a letter stating they had given so many hours and driven so many miles to do their Volunteer work.

Mrs. Charlotte Lee, Box 214, Emerson, Ia., 51533 drives 3 members of the American Legion Auxiliary from Malvern to the VAMC in Omaha, Ne. on the first Monday of the Month, which is approximately 102 miles (round trip), then each Tuesday she takes myself to the Glenwood State Hospital School, which makes her trip 40 miles round trip. Then she serves on a Human Resource Committee at the State School which meets once a week. To her the 22 cents a mile would mean quite a lot. A tax credit of 1500 dollars limit.

Harley Cooper, an employee at the State School suggested that a tax credit of $5 per 100 hours of Volunteer time be given to the Volunteers up to $100. This would be verified by the letter from the VAVS or State Schools.

If the Government would issue food stamps to persons over 55 (if they were Volunteering and meeting the other requirements for the program and needed them) with out registering with the Job Service. Especially, where there is no public transportation and you have to pay someone $10 per trip and go three times to be eligible for food stamps.for 6 months. You also have to go 16 different places to see about work and then drive approximately 80 to 90 miles round trip when there is a Job Service Office within 20 miles round trip. Then the Job Service spends money to verify the fact that you have been at that place looking for work, This is done by telephone.

As an example, my income is below proverty and with no transportation of my own and no public transportation to get someplace else to look for a job, but do have a ride to Volunteer work and I can't get food stamps.

Do you know what the deal is with the Government trying to take away the Veteran Organization's Non-Profit Status because of them having paid Lobbyist? And is there anyway, by writing the Legislators that I can help keep the Non-Profit Status.

Sorry, I haven't back to you soomer, but, thought I might get some more idea.

If there is anyway I can help let me know.

Sincerely,

Mrs. Sylvia J. Klonis
Box 37
MALVERN, IOWA
51551

American Legion PUFL 8264
1982 card Number IA.2-PUFL-0039
Post 520 Unit 520
American Legion Auxiliary Card No. B460452
Member of Ia. American Legion & Natl. Press Assocs.

General	1979-80	1980-81	1981-82
Membership current year (as of reporting date)	1,548,014	1,530,377	1,502,593
Membership past year (final)	1,556,020	1,541,064	1,525,653
New members initiated	40,478	40,806	37,960
Net assets	$525,197,915	$437,682,575	$629,775,063
IRS Form 990 filed	4,099	3,730	3,975
Post home owned debt free	3,482	3,354	3,589
Post home owned with debt	1,152	1,001	1,020
Post home rented	416	514	534
No cost for Post home	738	668	753
Other arrangement for Post home or meeting place	397	256	365
Rehabilitation			
Rehabilitation cases handled	355,101	236,395	471,766
Powers of attorney granted	87,097	50,211	63,832
Cash aid given veterans	$774,645	$635,245	$848,115
VAVS hours donated	904,996	388,540	1,018,754
Posts with Veterans Affairs and Rehabilitation Committee	1,354	1,359	1,462
Posts with Service Officer	5,322	5,325	5,567
Operation Post Home (new 80-81 category)	-	2,131	2,320
National Security			
Pints of blood given	113,207	105,692	112,509
Legion blood donors	62,572	58,755	59,318
ROTC medals given	3,972	3,585	3,891
Posts with crime resistance program	747	786	971
Posts working with Red Cross in disaster relief (new 81-82 category)	-	-	1,025
Public Relations			
Posts with Public Relations Chairman	3,480	3,539	3,812
Posts with regular paper or bulletin	2,806	2,776	2,910
Communications by cable television	364	258	444
Communications by radio	1,553	1,351	2,060
Communications by television	281	376	452
Communications by press (new 80-81 cat.)	-	3,585	4,035
Uniformed Groups			
Posts sponsoring color guard	3,400	3,505	3,779
Posts sponsoring firing squad	3,080	3,243	3,451
Posts sponsoring drum and bugle corps	178	174	180
Posts sponsoring band	161	149	156
Posts sponsoring drill team	300	337	364
Posts sponsoring other uniformed groups	0	229	259
Cost of uniformed groups	$1,330,911	$1,546,378	$1,505,759
Economic			
Posts with veterans employment program	1,160	1,138	1,140
Veterans assisted with finding jobs or training	28,422	33,785	26,374
Americanism			
Boys State			
Boys sponsored	16,034	15,515	16,979
Posts participating in Boys State	5,086	4,967	5,356
Cost of sending boys	$1,423,235	$1,510,459	$1,762,506
Baseball			
American Legion Baseball teams sponsored	2,012	2,037	2,127
Other athletic teams sponsored	2,225	2,295	2,321
Cost of all athletic teams	$4,711,042	$5,251,377	$5,984,372

AMERICAN LEGION POSTS - 1983 CONSOLIDATED REPORTS NATIONAL SUMMARY

General	1980-81	1981-82	1982-83
Membership current year (as of reporting date)	1,530,377	1,602,593	1,493,834
Membership past year (final)	1,541,064	1,626,653	1,530,741
New members initiated	40,806	37,960	35,297
Net assets	$497,682,675	$629,775,063	$552,972,133
IRS Form 990 filed	3,780	3,975	3,854
Post home owned debt free	3,354	3,589	3,453
Post home owned with debt	1,001	1,020	1,024
Post home rented	514	534	504
No cost for Post home	668	753	564
Other arrangement for Post home or meeting place	356	365	340
Rehabilitation			
Rehabilitation cases handled	296,395	471,756	258,195
Powers of attorney granted	50,211	63,832	44,495
Cash aid given veterans	$685,245	$848,115	$790,555
VAVS hours donated	888,640	1,018,754	965,109
Contributions to VAVS program (new 1982-83 category)	-	-	$777,502
Posts with Veterans Affairs and Rehabilitation Committee	1,359	1,462	1,426
Posts with Service Officer	5,325	5,667	5,452
Operation Post Home	2,131	2,320	2,248
National Security			
Pints of blood given	105,692	112,509	301,793
Legion blood donors	58,755	59,918	59,576
ROTC medals given	3,585	3,391	5,245
Posts with crime resistance program	786	971	957
Posts working with Red Cross in disaster relief (new 1981-82 cat.)	-	1,025	1,023
Public Relations			
Posts with Public Relations Chairman	3,539	3,312	3,580
Posts with regular paper or bulletin	2,776	2,910	2,773
Communications by cable television	358	444	494
Communications by radio	1,851	2,060	2,004
Communications by television	376	452	468
Communications by press	3,585	4,035	3,651
Posts with ½" VHS player/recorder (new 1982-83 category)	-	-	504
Uniformed Groups			
Posts sponsoring color guard	3,505	3,779	3,522
Posts sponsoring firing squad	3,243	3,451	3,314
Posts sponsoring drum and bugle corps	174	180	156
Posts sponsoring band	149	156	149
Posts sponsoring drill team	337	364	373
Posts sponsoring other uniformed groups	229	269	275
Cost of uniformed groups	$1,546,978	$1,505,759	$1,567,492
Economic			
Posts with veterans employment program	1,138	1,142	1,101
Veterans assisted with finding jobs or training	33,785	25,374	20,412
Americanism			
Boys State			
Boys sponsored	15,615	16,379	16,110
Posts participating in Boys State	4,987	5,356	5,083
Cost of sending boys	$1,510,459	$1,762,506	$1,740,351
Baseball			
American Legion Baseball teams	2,037	2,127	2,033
Other athletic teams sponsored	2,295	2,321	2,314
Cost of all athletic teams	$5,261,977	$5,984,372	$5,339,403

Americanism (cont.)	1980-81	1981-82	1982-83
Boy Scouts			
Boy Scout units sponsored by Posts	1,392	1,458	1,418
Scouts in Legion-sponsored units	36,527	38,316	33,854
Legionnaires active in Scouts	6,177	7,757	7,747
Cost to Posts	$409,404	$466,551	$576,475
School Awards			
School awards granted	19,394	21,050	20,482
Posts making awards	3,316	3,481	3,339
Cost of awards	$323,342	$361,773	$381,464
Oratorical Contest			
Posts active in program	1,092	1,236	1,099
Youths competing	4,676	5,119	4,897
Cost to Posts	$88,604	$112,586	$120,693
Education and Scholarships			
Number of scholarships awarded (new 1982-83 category)	-	-	3,336
Cost of scholarships	$765,661	$830,284	$916,823
Patriotic Events			
Posts observing Veterans Day	4,772	5,198	4,988
Posts observing Memorial Day	5,997	6,527	6,268
Posts observing July 4	3,339	3,578	3,545
Posts observing Legion birthday	4,708	5,002	4,843
Posts observing American Education Week	1,141	1,181	1,207
Posts observing Four Chaplains Sunday (new 1982-83 category)	-	-	1,321
Community Service			
Hours given to community service	2,707,206	2,807,136	3,163,901
Posts reporting community service	4,279	4,532	4,206
Special Olympics			
Special children aided	17,567	21,937	23,235
Posts participating in program (new 1981-82 category)	-	855	848
Cost to Posts	$306,637	$330,138	$406,390
Children and Youth			
Cash aid given to children and youth	$876,583	$939,392	$1,110,053
Value of goods given to children and youth	$1,290,763	$1,288,442	$1,468,864
Cost of extras (parties, gifts)	$1,493,149	$1,718,580	$1,718,456
Cost of other activities to benefit children	$1,053,729	$1,388,898	$1,066,213
Children given direct aid	184,042	175,673	168,009
Children benefitted in other ways	556,854	677,968	785,890
Contributions			
Mental health	$90,653	$123,459	$92,679
United Fund	$140,560	$160,784	$140,695
Retarded children	$317,772	$321,986	$334,398
Red Cross	$81,941	$91,224	$100,869
American Legion Child Welfare Found.	$38,104	$41,012	$31,867
Cancer	$163,183	$141,644	$120,260
Other contributions	$1,650,527	$2,027,809	$2,043,526
Crippled children	$209,577	$219,270	$236,182
Legislative			
Posts with active Legislative Chairman	2,185	2,334	2,197
Posts subscribing to National Legislative Bulletin	1,316	1,448	1,356
Energy			
Posts with Energy Committee	1,379	1,323	1,238
Percentage of all Posts reporting	43.14%	47.78%	45.01%

BRIEF HISTORY OF THE AMERICAN LEGION

CHAPTER I

Foreword

ATEVER ELSE war is—and it has been described in every way, from ne slightly profane word to countless pages of histories and novels— unique and memory-stirring experience for those who were most ely involved as members of the armed forces. From the shared ex- es and the quickened feeling of kinship have sprung many organi- of ex-servicemen.

hile George Washington's army was still in the field, officers of the ental Army formed the nation's first veterans' association—the Society Cincinnati.

day there is no accurate record of the total number of veterans' organi- s, but among them all, none has grown so large or has exercised such nfluence as has The American Legion. None is so intimately identified he word "veteran." Since its origin in 1919 this largest of all veterans' zations has become as integral and accepted a part of the American as hot dogs, baseball, and Presidential elections.

w did The American Legion achieve such a meteoric rise? With es and words, the following pages will trace the story of this giant erans' organizations from its conception on a foreign soil.

radle Days

E AMERICAN LEGION was born at a caucus of the first American Ex- editionary Force, March 15-17, 1919, in Paris, France. This caucus was sult of a proposal previously offered by Lt. Col. Theodore Roosevelt, a group of representatives of A. E. F. divisions and service units. velt assisted in planning the Paris caucus, March 15-17, 1919, and to order the subsequent caucus in the United States, May 8-10, 1919, Louis, Missouri. His outstanding service during these vital periods of ization won for him the affectionate title "Father of The American n."

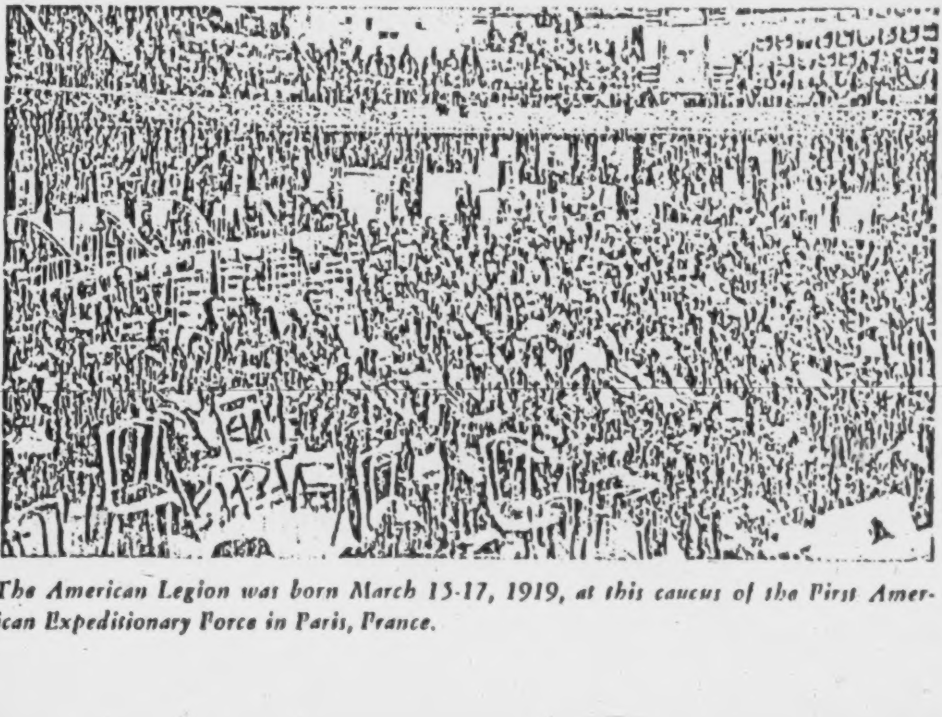
s the weary, homesick delegates assembled for the Paris caucus, they ght with them the raw materials with which to build an association of ans whose primary devotion was to God and Country. In the minds hose men of the A. E. F. were a number of lofty ideals, uppermost ng which were:

The title "Father of The American Legion" belongs to Theodore Roosevelt, Jr., who not only contributed a large portion of the initiative which resulted in the Paris Caucus but also served as temporary chairman of the St. Louis Caucus.

1. Creation of a fraternity based upon firm comradeship, born of war service, and dedicated to equitable treatment for all veterans, particularly the disabled, their widows, and their orphans;
2. National security for America, including a universal military training program for the prevention of future world conflicts;
3. Promotion of patriotism and the combating of materialistic and totalitarian ideologies which recognize neither the honor nor the dignity of the individual.

It was at this Paris caucus that The American Legion received its name. The distinction of naming the new organization went to Maurice K. Gordon, then a major in the 36th Division and later a judge in Kentucky. A controversy had developed concerning the name, and it was Gordon who made the successful motion to label the infant group The American Legion.

While lofty principles had been expounded at the Paris caucus, it was decided to leave the definition of permanent policies for a later and more representative meeting to be held in the United States. An executive com-



The American Legion was born March 15-17, 1919, at this caucus of the First American Expeditionary Force in Paris, France.

mittee of 100 members was named to complete the organization in the A. E. F. while a sub-committee of 17 returned to the United States to promote interest among those who had already returned to the States.

Even though The American Legion was formed overseas, it was realized that members of the armed services have no choice as to where they serve —in the United States or overseas. Accordingly, it was decided that membership in The American Legion should be open to all veterans who had served honorably in the armed forces in World War I. (Eligibility requirements for membership have since been revised to permit veterans who served honorably in the armed forces of the United States in World War II, Korean War and the Vietnam era to join The American Legion.)

St. Louis Caucus

"A representative democracy in a federal republic" was the plan adopted by the Paris caucus for the formation of The American Legion. Advance committees of two members from each state met May 6, 1919, in St. Louis, Missouri, to prepare for a general caucus May 8-10, 1919, there. This St. Louis caucus, attended by some 1,100 delegates, produced the blueprint of The American Legion, approved the principles set forth at the Paris caucus, adopted a tentative constitution, and created the machinery to provide for a permanent organization.

It was at the St. Louis caucus that the now famous Preamble to the Constitution of The American Legion was put into final form. A short preamble had been written at Paris by a sub-committee consisting of Frank White, William H. Curtiss, and Redmond C. Stewart. In St. Louis the now immortal Preamble was conceived by the fertile minds of John C. Greenway of Arizona, Hamilton Fish of New York, and George N. Davis of Delaware.

Organization work proceeded rapidly after the St. Louis caucus. Temporary offices were opened in New York City. On September 16, 1919, the Congress of the United States chartered The American Legion, thus giving official sanction to the Constitution adopted in St. Louis.

The charter convention of The American Legion met November 10-12, 1919, in Minneapolis, Minnesota. The rapid pace with which The American Legion was building its organization was evident by the presence of many delegates still in the uniforms of the armed forces. The Minneapolis convention of 1919 approved the acts of the temporary organization and adopted a permanent structure. The first American Legion National Convention parade—which was to set the pace for what has become the utmost in pageantry, color and martial music—was on the first anniversary of Armistice Day, November 11, 1919. Included in the line of march were the 648 delegates representing the infant organization's membership of 648,000.

A somber note was injected at this first convention with the arrival of news that four Legionnaires of a newly formed post at Centralia, Washington, while marching in the Armistice Day parade in their home city, were shot down in cold blood by members of the Industrial Workers of the World, a radical group incited by propaganda based on class hatred. Thus did The American Legion receive its first challenge by un-American elements, some of which to this day classify the Legion as their greatest enemy.

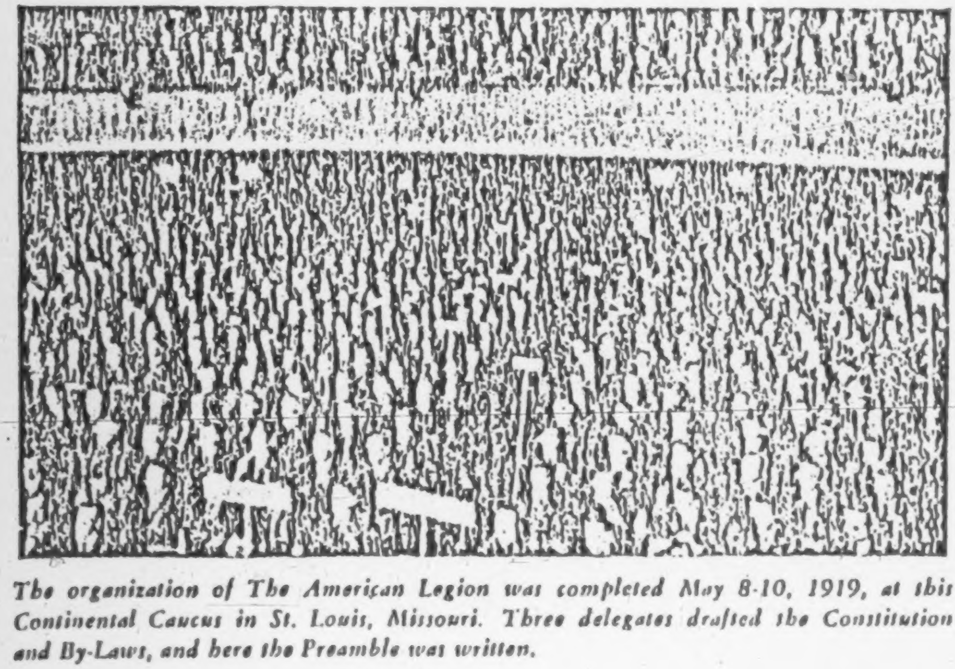
Franklin D'Olier of Pennsylvania became the first National Commander, and Lemuel Bolles of Washington, the first National Adjutant. D'Olier later became president of the Prudential Insurance Company, and performed several non-salaried tasks for his country during World War II.

Representatives of five cities—Detroit, Indianapolis, Kansas City, Minneapolis, and Washington, D. C.—vied to gain the new organization's permanent national headquarters. Indianapolis won, and the national headquarters of The American Legion were moved in late 1919 from their temporary location in New York City to the Hoosier capital.

II. *Veterans Affairs and Rehabilitation*

THE FOUNDERS OF The American Legion, when they met at the St. Louis caucus, recognized that a major concern of the organization would be the plight of the disabled veteran. The extent of the concern for these men is evident in the final phrase of the Preamble, "to consecrate and sanctify our comradeship by our devotion to mutual helpfulness."

The D'Olier administration completed organization of the National Service Bureau, which worked with state service bureaus and service officers of individual posts to assist veterans with problems of war risk insurance,



The organization of The American Legion was completed May 8-10, 1919, at this Continental Caucus in St. Louis, Missouri. Three delegates drafted the Constitution and By-Laws, and here the Preamble was written.

compensation for disabilities, hospital treatment, and vocational training. The American Legion received financial assistance in this phase of the program from the American Red Cross.

Immediately after the close of the 1920 convention in Cleveland, Ohio, National Commander Frederick W. Galbraith, Jr., called a conference in Washington, D. C., to consider the plight of disabled veterans resulting from an unwieldy mass of laws and regulations administered by several different government bureaus. Out of that conference came The American Legion's request for a Presidential committee to investigate existing conditions. As a result, the Dawes Committee, which included representatives of The American Legion, was appointed. The Dawes Committee report, accompanied by White House recommendations, brought about Congressional action consolidating most of the activities dealing with World War I veterans into a new independent agency—The United States Veterans Bureau (now the Veterans Administration).

The Veterans Bureau continued under careful study by The American Legion during the next two years, and many reforms were suggested by Legion leadership and put into effect, eliminating abuses that deprived veterans of hospital treatment and other rights authorized by Congress. It was in the same period that The American Legion improved its own procedures of handling veterans' matters by organizing the National Rehabilitation Committee to promote better administration of this important and highly complex activity. The National Rehabilitation Committee later became the National Rehabilitation Commission and, as the result of action taken by the 1970 National Convention, it was renamed the National Veterans Affairs and Rehabilitation Commission.

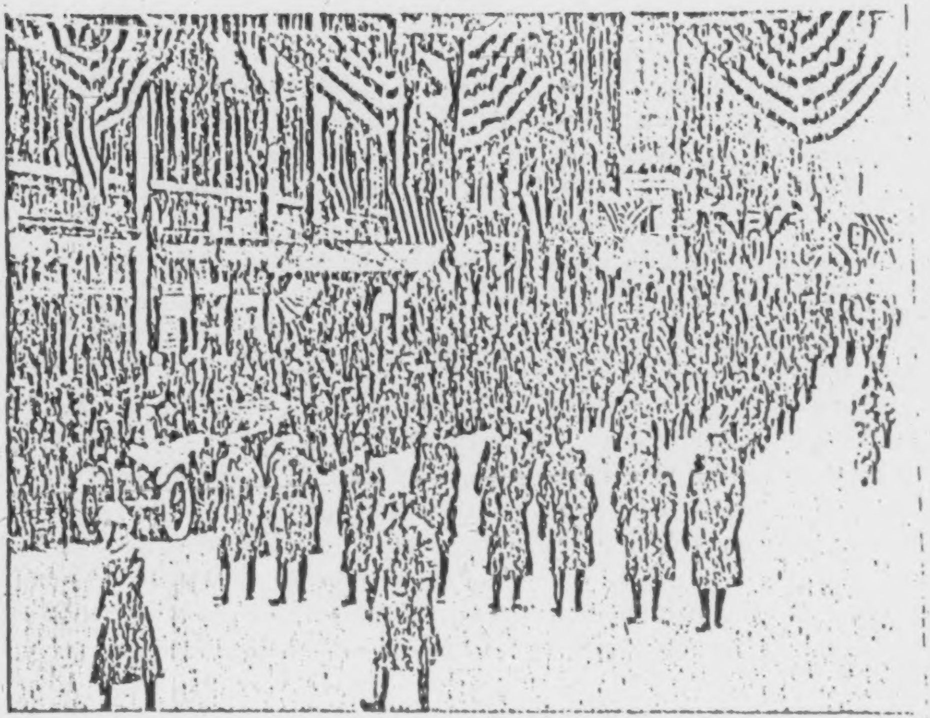
Justice for the disabled veteran was now The American Legion's fight in earnest. In 1923 the San Francisco Convention drafted 91 constructive recommendations for liberalization of laws and regulations governing veterans' benefits. Before the next National Convention was to gather, Congress had enacted the World War Veterans Act of 1924, which included many of The American Legion's proposals and extended the presumption of service connection for certain classes of disability.

Throughout the remainder of the 1920's and early into the 1930's, The American Legion continued to register legislative achievements necessary for the care and rehabilitation of disabled veterans.

Veterans Administration Established

On July 21, 1930, the Veterans Bureau and other agencies administering veterans' benefits were consolidated in the Veterans Administration, a new independent agency which thereafter handled most veteran benefit programs.

The American Legion's cause in behalf of disabled veterans' benefits faced one of its greatest challenges during the depression of the early 1930's. In



Delegates to the First National Convention, November 10-12, 1919, at Minneapo Minnesota, paraded in a snowstorm on the first anniversary of the Armistice, Novem 11.

1933 the new national administration passed what has since been know as the infamous Economy Act, which wiped out a wide range of progra and benefits which had been won for disabled veterans by patient effo since the end of World War I.

However, The American Legion rallied to the crisis in veterans' affai The National Rehabilitation Committee at the convention in Chicago th same year put forth the famous Four-Point Program. This was, briefly, tha

1. No veteran disabled in line of duty suffer any reductions in benefi granted under legislation in effect prior to March 19, 1933;
2. Federal hospitalization be afforded veterans not dishonorably dis charged, requiring such care, and unable to pay reasonably for treat ment;
3. Participation of service connection for all veterans properly grante such service connection under law in existence prior to March 20 1933, be continued;
4. Benefits provided for dependents in the World War Veterans Act be restored and the thought established that in no event should widow and orphans of deceased World War veterans be without governmen protection.

The American Legion's unceasing fight in behalf of disabled veterans was rewarded March 28, 1934, when Congress enacted Public Law 141, carrying out in full the recommendations of the first three provisions of the Four-Point Program. Although this bill met with a Presidential veto, Congress overrode the veto. Thus, The American Legion recorded an outstanding accomplishment in the restoration of the major part of the benefits taken from disabled World War veterans by the Economy Act.

From this significant milestone, The American Legion has worked successfully for the passage of further legislation, liberalizing benefits for disabled veterans and bringing about the fourth provision of the Four-Point Program concerning protection of widows and orphans.

Since that major victory in 1934, the Legion has repeatedly mustered its resources to meet effectively subsequent challenges to reduce the role of the Veterans Administration in its essential mission of providing for our sick and disabled veterans. The increasing demand for VA hospital and medical services resulting from the returning wounded and disabled from Vietnam not only justified the Legion's earlier position in this matter but also strengthened its intensified endeavors for adequate Congressional appropriations to meet some of the needs of the newest generation of disabled war veterans.

III. *Children and Youth*

CLOSELY ALLIED with its concern for the disabled veteran is The American Legion's interest in the welfare of the children of deceased and disabled veterans. There is no definite time nor place which can be described as the beginning of The American Legion's Children and Youth Program (formerly known as Child Welfare Program). Like many of the purposes and principles set forth in the Preamble, the child welfare concepts undoubtedly were first formed on the battlefields of France during World War I, where shared dangers and hardships created a deep sense of responsibility for the children of fallen comrades.

The American Legion has two child welfare objectives: first, to assure care and protection for the children of veterans; second, to improve conditions for *all* children. These objectives are expressed in slogan form as "A Square Deal for Every Child."

First activities in the field of child welfare by The American Legion were carried on by Legion rehabilitation workers, who saw as early as 1922 that there was a need for special effort on behalf of these unfortunate youngsters.

In the mid-20's American Legion child welfare efforts were centered about the establishment of Legion-operated institutions known as "billets," where children of deceased and disabled veterans were housed and cared for. However, the experience of only a few years proved the institutional approach inadequate and unsatisfactory. A new concept of child care gradually emerged, placing central emphasis on the maintenance of the family home.

In 1925 a National Child Welfare Division was established in National Headquarters at Indianapolis. Within three years, the national organization had completely withdrawn from the institutional field and, in its place, was furthering a program of direct temporary assistance to needy children in their own homes.

This forward step by The American Legion, which was considered a new concept in child care, gave great impetus to the development of programs by many other organizations, both public and private, for the home care of children.

In order to finance its child welfare and rehabilitation programs, at least in part, The American Legion in 1924 launched a campaign to raise a $5,000,000.00 endowment fund. This goal was reached in little more than a year. In 1945 the endowment fund was increased to $7,000,000.00. In addition, the national budget for children and youth received generous contributions annually from the Legion's affiliated organizations—the American Legion Auxiliary and the Eight and Forty, and, up to 1959, from the Forty and Eight.

Emphasis Shifted to Concern for All Children

After World War II, the National Child Welfare Commission recognized the need to place added emphasis on sound public programs for all children in order to fulfill the purpose of guaranteeing care and protection to children of veterans. Because of the greatly increased segment of the nation's population which now was classified as "veteran" it was evident that the majority of all children in the United States would be of veteran parentage.

The change in emphasis to encourage and support good public programs for all children was the major factor in permitting The American Legion to fulfill its purposes in this area.

The National Child Welfare Commission recognized that many of the larger problems of child welfare cannot be met on the basis of direct help

One of the major areas of interest within The American Legion's Children and Youth Program is the education of the handicapped child, particularly the child who is multiply handicapped. Posts, districts, and departments are encouraged to participate jointly in programs with other organizations to meet the needs of these children.

to individual children. For example, immediately after World War II, a major cause of death among school age children was rheumatic fever and rheumatic heart disease. As a result of the joint interest of the National Child Welfare and Rehabilitation Commissions, the National Executive Committee in 1946 appropriated $25,000.00 to the American Heart Association to begin research on this problem. The American Legion Auxiliary appropriated a like amount, and the $50,000.00 so provided, in a large measure, launched the present program of the American Heart Association. As a result of this organization's research in medical science, we now know that rheumatic heart disease is an outgrowth of rheumatic fever and that rheumatic fever can actually be prevented. The research which was financed by this grant has been an important contribution to the decline in the rheumatic fever death rate among children.

Similarly, in 1950 The American Legion contributed $25,000.00 to the National Association for Mental Health, and the progress which has been made by research financed by this organization indicates that substantial results are being achieved in this critical area.

In order to avoid possible public misunderstanding of the purpose and scope of its child welfare program, The American Legion, by action of its 1970 National Convention, amended its Constitution and By-Laws in order to redesignate the National Child Welfare Commission as the National Commission on Children and Youth. This change did not affect the composition, purpose, or functions of the Commission and its program.

The American Legion Child Welfare Foundation, Inc.

By 1954 the wisdom of the grants to the American Heart Association and the National Association for Mental Health was quite apparent, and the need was felt for a recognized method by which future grants could be made which would bring the best results to the greatest number of children. In that year The American Legion Child Welfare Foundation, Inc., was authorized by the National Executive Committee with these two primary purposes:

1. To add to the sum total of man's knowledge about children and youth through research, study, etc.;
2. To help distribute information society already possesses about children in order that such information may be more adequately used.

This Foundation in no way supplants or supersedes The American Legion's traditional and continuing program for children and youth. Through its stimulation of preventive research, the acquisition and wide application of new knowledge and similar long-range efforts, the Foundation will supplement and make even more effective The American Legion's long standing program of direct assistance, legislation pertaining to children and youth, and general public information to further the streamlining of child care concepts. The Foundation is supported primarily through the generous contributions of individuals, posts, units, departments, and the national organization of the American Legion Auxiliary. Currently memorial contributions for departed comrades made by individuals, posts, and units provide a part of its income.

But even more important than its income are the grants which the Foundation has made and the results which have been achieved. The Foundation is authorized to use such funds as are put at its disposal for the benefit of children and youth, with emphasis on research, special projects, and demonstrations. It has already made grants in the fields of juvenile delinquency, retarded children, mental health, institutional care, education, physical medicine, and specific areas of need, such as the study of alarmingly increased rates of venereal disease among teenagers, and increased emphasis on understanding and training children who are partially sighted.

The Foundation, though still small, has had tremendous national impact and the results of its work are already beginning to be felt. The Foundation is actually private enterprise in philanthropy, and just as our private enterprise system has proved so highly productive in the field of business and industry so also is private enterprise becoming equally fruitful in the broad field.

IV. *Americanism*

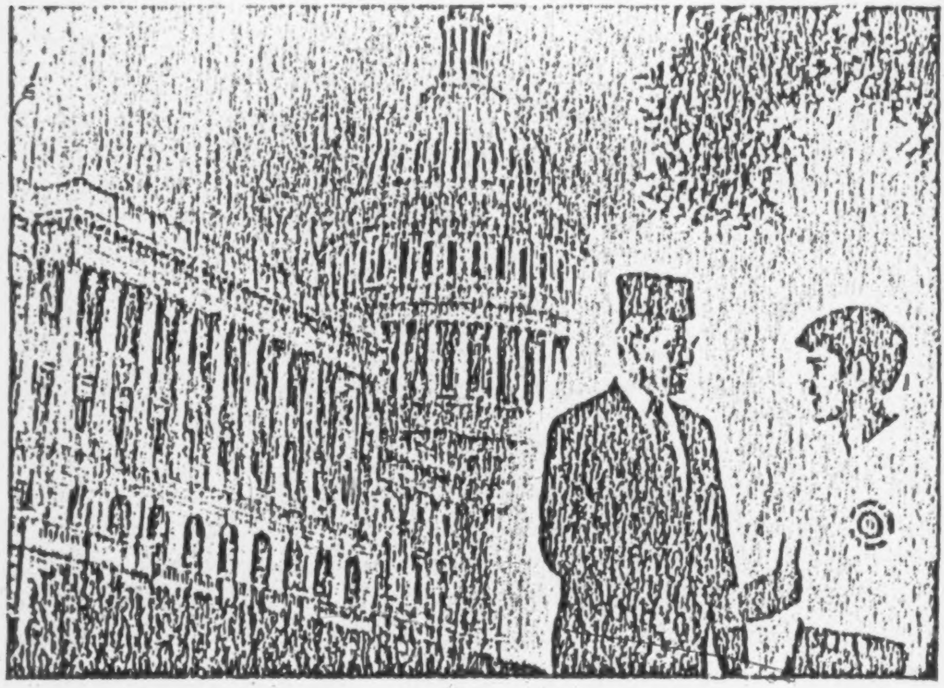
FROM ITS VERY beginning The American Legion was not content to confine its interest and support to easing the plight of the deceased and disabled veterans and their dependents. It also took as one of its major projects the preservation and furtherance of basic American concepts and principles. The St. Louis caucus in May 1919, considered as "its major concern—relief work, employment, and Americanism." At the charter convention that same year in Minneapolis, the National Americanism Commission was established. Its first assigned responsibilities included the combating of anti-Americanism tendencies, the education of citizens old and new in the ideals of true Americanism, the distribution of information about "the real nature and principles of American government," and the fostering of the teaching of Americanism in all schools.

It is the objective of the National Americanism Commission to translate Americanism precepts, principles, and ideals in an understandable manner to posts and to other groups and individuals.

This mission has led the National Americanism Commission over a sometimes difficult route. Early in the 1920's, unemployment and a period of general national unrest coincided with an upsurge of communism and other subversive theories. The Americanism Commission has met these challenges through the years with education and action.

Much of the Commission's work was concerned with the problems of unemployment until that particular phase was assigned as a responsibility of the National Economic Commission.

In order "to foster and perpetuate a 100 percent Americanism," a large segment of the Americanism Commission's total effort is channeled into education programs and citizenship activities for our youth—the leaders of tomorrow. Millions of America's youth have gained a better understanding of the Constitution of the United States through The American Legion's National High School Oratorical Contest, in which several thousand students participate annually.



The annual session of American Legion Boys Nation draws the two most outstanding young men from each of the department-sponsored Boys States to Washington, D.C., for a first-hand look at the workings of the federal government.

Boys State and Boys Nation

For more than a quarter century, American Legion Boys States have given an inside look at the demands of good citizenship and civic responsibilities to about 30,000 of tomorrow's citizens attending these annual summer workshops in governmental operations. Boys Nation, which has functioned annually since 1946 in Washington, D. C., brings the most outstanding of these young American leaders to the nation's capital for even greater insight into the workings of the federal government.

Each year hundreds of thousands of American boys improve their physical fitness and develop a keener sense of good sportsmanship, good citizenship, and fair play through American Legion Baseball, which has been in existence since 1926. This program, which enjoys financial support and valuable assistance from organized baseball, has also proved to be a fruitful proving ground for some of the finest talent in the history of this great American game.

As a part of its Americanism program, The American Legion encourages the recognition of students who display the highest qualities of citizenship. American Legion School Medal Awards are presented annually to about 27,000 boys and girls in elementary, junior, or senior high schools who are outstanding in honor, courage, scholarship, leadership, and service.

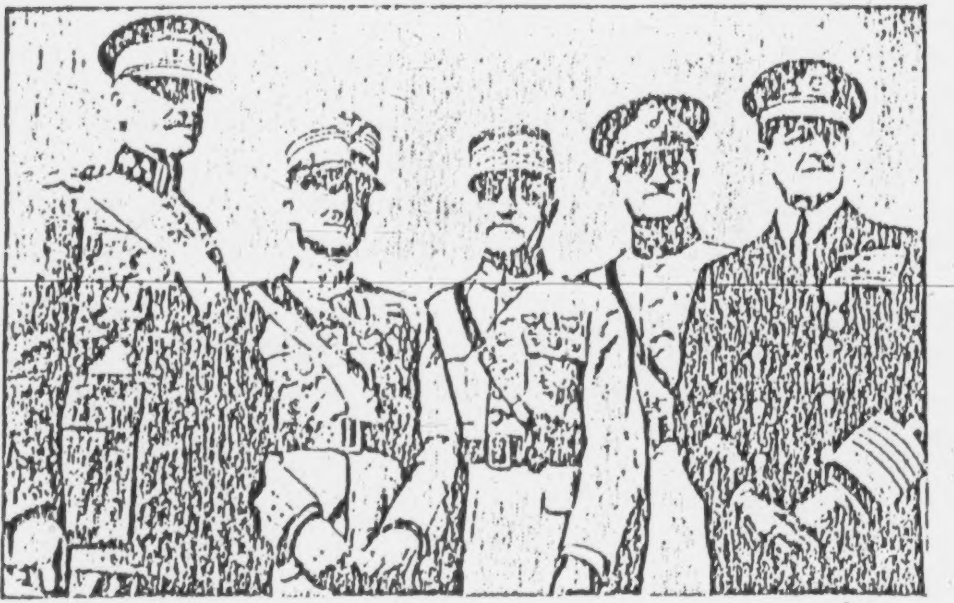
In support of the outstanding citizenship training, character building, and physical development programs set forth by the Boy Scouts of America, American Legion Posts throughout the Nation sponsor about 2,700 Scout units—Cub Packs, Scout Troops, and Explorer Units.

American Education Week was founded in 1921 by The American Legion. From the beginning, the aim of this promotion has been the improvement of citizenship. The Legion has since been joined by the National Education Association, the United States Office of Education, and the National Congress of Parents and Teachers in sponsorship of this program.

By action of the National Executive Committee at its May 1961 meeting the education and scholarship program which had been under the supervision of the National Child Welfare Commission was transferred to the National Americanism Commission. In 1951 this program published a career and scholarship handbook, "Need A Lift?", which has been revised and expanded annually to become recognized today as one of the most complete sources of this information available in the United States. This handbook is distributed each year to American Legion posts and units that they may offer its information as assistance to the interested students and their parents in the community.

Our present Flag Code is the result of a cooperative effort in which The American Legion played a leading role in encouraging proper respect for an etiquette in display of the national colors. Great quantities of literature are mailed from the National Americanism and Children and Youth Division each year to stimulate patriotism and recognition of patriotic holidays. The sole purpose of this material is to assist Americans to be good citizens and to instill in their youngsters an enduring enthusiasm toward the American way of life.

In the field of anti-subversive activities The American Legion has gained nationwide recognition as the outstanding opponent of communism and other anti-American dogma. To combat the dangers presented to the perpetuation of the American way of life by these doctrines, the countersubversive section of the Americanism Commission has gathered data which has been filed and catalogued in order that any Legionnaire through his



Allied leaders of World War I, as guests of The American Legion, meet again on the platform of the Third National Convention October 31-November 2, 1921, in Kansas City, Missouri. Left to right: Lieutenant General Jacques of Belgium, General Diaz of Italy, Marshal Foch of France, General of the Armies John J. Pershing, and Lord Beatty of Great Britain.

post and department may have at his command one of the best library and information services on subversives and subversive activities available anywhere. The dedicated efforts of this program are also implemented through the publication of a monthly news letter, "*FIRING LINE*," a timely summary of information on domestic subversive activities.

V. *National Security*

THE DEEP-ROOTED interest of The American Legion in the security of the nation was born in the hearts and minds of its founders and those who piloted it through the treacherous waters of its early years. The bitter experiences of seeing comrades wounded and killed through lack of proper training crystallized the determination of these veterans to fight for an adequate defense establishment capable of protecting the sovereignty of the United States.

The tragic events of World War I, largely precipitated by unpreparedness, were still vivid in the minds of all combat veterans when the committee on military policy met at the 1919 National Convention in Minneapolis. The charter convention approved ten committee resolutions which embodied these important principles: Universal Military Training, retention of a small Regular establishment and creation of a citizens' army composed of an Organized Reserve and National Guard units.

In the intervening years, this original committee has grown to become the National Security Commission and Committees, which focus Legion attention to all segments of the nation's defense. In years since the birth of The American Legion, the United States has engaged in another World War and fought in Korea and Vietnam to oppose further aggression by the Communists. Perhaps these wars would not have occurred had our nation followed the pattern of American Legion recommendations on National Security matters.

During the 22 years separating the birth of The American Legion and the attack on Pearl Harbor, which brought the United States into World War II, The American Legion had been a consistent, though too often unheeded, voice advocating adequate military strength.

National Defense Act of 1920

The efforts of The American Legion, acting through its National Security Commission and Committees, resulted in the enactment of the National Defense Act of 1920, which gave the nation its first workable plan for a small Regular Army, augmented by a large National Guard and Organized Reserve. However, because appropriations for carrying out the provision of this act were repeatedly denied, the military establishment—which at the end of World War I had been as well prepared as that of any country in the world—was steadily reduced.

In the face of discouraging setbacks, The American Legion continued to propose recommendations which have had a profound effect on our nation's history. Twenty years prior to Pearl Harbor, The American Legion was calling for the equivalent of a two-ocean navy and firmly supported the development and utilization of a new weapon system, the airplane.

Throughout those 20 years prior to our entry in World War II, The American Legion remained unrelenting in its struggle for a strengthened national defense. In 1938 The American Legion demanded an air force of 8,000 planes and a production of 1,500 planes annually; a strengthening of our Pacific defenses, and the discontinuance of shipment of war supplies to Japan. Had it not been for The American Legion's efforts to alert America to the need for continuing preparedness, our nation at the time of Pearl Harbor would have been notably weaker than it was.

After the surrender of Germany and Japan in 1945, The American Legion again faced the unpleasant task of calling for a retention of adequate military strength in the face of an overwhelmingly popular demand for demobilization. Despite American Legion opposition, the American people permitted the greatest defense machinery in history to disintegrate and in so doing, encouraged communist aggression throughout the world.

Just as it had after World War I, The American Legion after World War II urged the Congress to enact Universal Military Training legislation, but it took the commitment of American manhood to fight again on foreign soil, this time in Korea, to convince the nation's lawmakers of the vital need of a Universal Military Training program. However, the legislation which embodied the principles of universal military training, which was passed by the 82nd Congress, contained several flaws which remained uncorrected until the enactment of the National Security Training Law, which was passed in July, 1955.

Today, with the evolution of space technology and scientific advancement of both conventional and nuclear weapons, The American Legion is again proving itself a pioneer by its insistent support of an adequate arsenal and a properly trained fighting force personnel as prime deterrents to aggressors.

VI. *Foreign Relations*

OF INTEREST TO ALL American veterans has been the subject of foreign affairs. This is as true today as it was with our nation's first veterans who, after the Revolutionary War, became leaders in the new republic. With each war the veterans became more intense in their desire to seek peace and national security. Such was the case with The American Legion following World War I. Not only did the veterans of this War have a keen desire to sustain peace, but they also had a solemn wish to perpetuate the battlefields and cemeteries overseas as living shrines to sacrifice and achievement. Thus, from its earliest convention, The American Legion expressed concern and interest in foreign affairs directed to these principles. Neither conservative nor liberal, neither international in character nor isolationist in principle, this foreign policy has been consistent in two respects: First, by continuing to protect American sovereignty and right; and secondly, by seeking world peace on the premise that the diplomatic front is often the first theater of operations which, if lost, inevitably leads to armed conflict.

In the period after World War I, while the infant veterans' organization was struggling for its very survival, its foreign relations policy was not as complex in character as it is today. Primarily, this policy was directed toward major items of concern to Legionnaires in the over-all interest of America, with special emphasis directed toward sustaining international peace. During the World War II period, the interest of The American Legion was essentially concerned with bringing the war to a successful conclusion and the securing of a world peace. Discussions during that period showed an interest on the part of many to create an international organization similar to that which is known today as the United Nations. Because the League of Nations, after World War I, had become a partisan, political issue in the United States, the young American Legion had neither endorsed nor repudiated this international organization.

Legion Supports United Nations

In 1945, then National Commander Edward Scheiberling was an observer at the conference in San Francisco where the United Nations organization took substantial form. At its National Convention that year in Chicago, The American Legion voted its full approval of the United Nations. At its next five National Conventions, The American Legion, recognizing weaknesses within the structure of the United Nations, advocated strengthening of the U. N. charter. The American Legion issued early and prophetic warnings that "the persistent misuse of the veto power by Soviet Russia is destroying the ability of the United Nations to prevent war," and that Russia "sought to sabotage the United Nations and thus weaken it for world peace and justice."

Thus it can be seen that at the conclusion of World War II and with the establishment of the United Nations, The American Legion's foreign relations policy bcame more intricate and complex. The veteran of World War II returned to civilian status far more internationally minded than his predecessor of World War I. He had served in the Pacific areas, in Europe, and in other regions of the world. He not only was keenly mindful of the extreme need for sustaining peace, but also he was intimately familiar with the many countries with which America must work in the future to maintain peace.

The Korean War eventually brought to the ranks of The American Legion a new veteran who, for the first time in American history, had fought as a member of an international force. Also, he was recognized as the first American veteran to meet in combat the ruthless communist forces which now seek to destroy the peace of the world. As a veteran and as a Legionnaire the man who had faced communism's fire has offered one more serious phase in the formation of The American Legion's foreign policy in recent years.

Foreign Policy Always Realistic

Thus, The American Legion's foreign policy, blueprinted at the St. Louis Caucus, endorsed and broadened at the first National Convention in Minneapolis, and adjusted to world conditions through the ensuing years, has always reflected realistic recommendations in the interest of promoting the security of America and peace and good will on earth.

Emanating from every community throughout the nation and representing all classes and religions in America, the foreign policy of The American Legion is a true reflection of the hopes and fears, the very desires and wants, of all America. In it are found the sentiments of the nation and through it a better American foreign policy can develop to insure the peace and freedom of the world.

VII. *Legislative*

As The American Legion began to take form in the spring and summer of 1919, its leaders soon saw the need for a central legislative agency which could present the Legion's legislative programs effectively to the Congress. Such an agency who also needed to avoid departmental competition for legislation, without regard to priority established by need or American Legion national policy.

Therefore, one of the first committees created was the National Legislative Committee (now Commission) which was established prior to the first National Convention at Minneapolis.

The early responsibilities of the National Legislative Committee are described adequately by Marquis James in his History of The American Legion: ". . . . an essential cog in the national machinery to make veterans' voices heard and heeded in the council chambers of the nation where the laws are made, in the executive offices where they are enforced, and in the hundreds of department bureaus, great and small, from which the actual administration is directed." With the development of other national commissions, the implementation and policing of veteran's laws were taken over by them.

The initial action of the newly formed committee was to request Congressional recognition of The American Legion. The 66th Congress gave its stamp of approval to "An Act to Incorporate The American Legion" which became Public Law 47 with the President's signature on September 16, 1919. The charter limited membership to honorably discharged veterans with service between April 6, 1917, and November 11, 1918. Subsequent amendments have been made which established eligibility dates for membership of veterans of World War II, December 7, 1941, to December 31, 1946; the Korean War, June 25, 1950, to January 31, 1955; and the Vietnam era, August 5, 1964, to May 7, 1975.*

The National Legislative Commission is not authorized to formulate policy; it is a staff agency only, charged with the exclusive responsibility of petitioning Congress in behalf of any and all legislation in which The American Legion is interested. Declaration of legislative policy is the right and responsibility of national conventions. Between conventions the National Executive Committee may mandate legislative action.

Legislative Commission Serves Entire Organization

Since it has no program of its own, the National Legislative Commission serves the entire American Legion, and the results of its work since 1919 are interwoven with the several American Legion programs. In the various states, department legislative committees operate on much the same basis, and their efforts have resulted in many legislative successes in such areas as rehabilitation, aid to war veterans, and child welfare.

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* Congressional action pending to amend Section 5 of the Charter of The American Legion. If adopted, the dates for the Vietnam era will be December 22, 1961 to May 7, 1975.

In 1919 war veterans returned to a national community which was almost totally unprepared to cope with the needs of the sick and wounded. There was scant provision for the alleviation of suffering and distress of the dependents of those who gave their lives in the war. There was little help toward the readjustment of thousands whose lives had been disrupted by service and who were in need of rehabilitation. It was a dark age for the returning defenders of democracy. On top of this came a postwar depression. There was no national agency, such as today's Veterans Administration; veterans' hospitalization was inadequate and unsatisfactory.

Such was the Herculean task which faced the infant American Legion and its legislative committee. The early years, 1919 to 1933, saw unrelenting legislative efforts by The American Legion in the attainment of such objectives as the creation of the Veterans' Bureau and then the Veterans Administration; realistic compensation programs for the disabled and their dependents; hospitalization for the disabled; adjusted compensation for the veterans; education programs for the service-connected disabled; and other veterans' benefits previously unknown.

In addition to beneficial legislation affecting veterans and their dependents, the National Legislative Committee's work in the fields of Americanism and national security also bore fruit. Its endeavors contributed to the passage of anti-subversive laws, as well as legislation to strengthen our military forces, including the National Guard and Organized Reserve. These were busy years for the Committee, and during that period The American Legion was recognized as having the most powerful and effective legislative lobby in Washington.

Compared to the standards of the time, the veterans' program at the beginning of 1933 was in excellent condition, but our nation was at the bottom of a great depression. The Legislative Committee of The American Legion had been so successful that economy-minded members of Congress, reinforced by the National Economy League, worked for the passage of "An Act to Maintain the Credit of the United States" which became Public Law 2 with the President's signature on March 20, 1933.

Passed by Congress without a hearing—with no opportunity being given The American Legion to oppose it—this measure contained the following provision: "All public laws granting medical or hospital treatment, domiciliary care, compensation and other allowances, pension disability allowance, or retirement pay to veterans and dependents of the World War are hereby repealed." One stroke of the pen wiped out 13 years of American Legion legislative effort.

Legislative Counter-Offensive Successful

Though rocking from the punch, The American Legion quickly organized a legislative counter-offensive. With one out of every five veterans in its ranks to give it strength, The American Legion took to the highways and byways and descended upon the crossroads of the nation to advise the people of the terrible consequences of Public Law 2. Meanwhile, the National Legislative Committee organized its plan of attack for the 1934 session of Congress. Overwhelming veteran support, combined with the Legislative Committee's testimony before Congressional committees, brought about a complete reversal by Congress on March 28, 1934. This measure became law over the President's veto. A great amount of credit for this notable achievement must be given to the indomitable spirit and courage of then National Commander Edward A. Hayes (deceased) of Illinois.

GI Bill of Rights

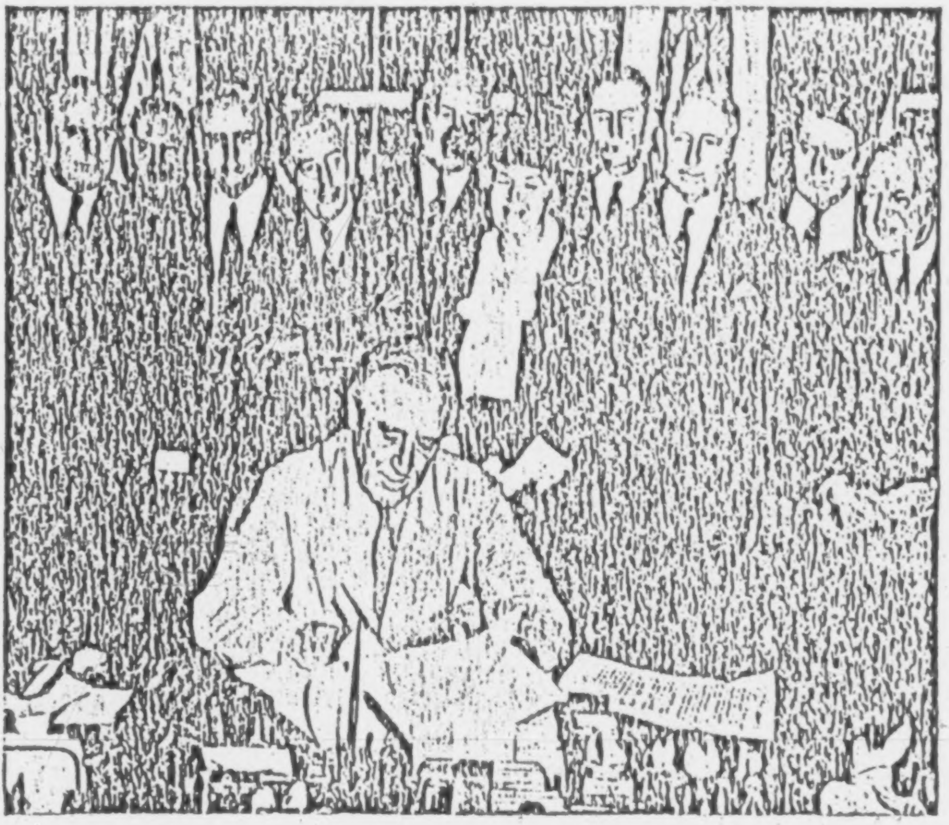
The greatest single legislative achievement of The American Legion was the enactment of the Servicemen's Readjustment Act of 1944, more popularly known as the GI Bill of Rights. Not only is The American Legion universally recognized as the originator of this omnibus bill, but also as the force which overcame political opposition by massing public opinion in favor of the measure.

With approximately fifteen million men and women in the armed services of the United States in World War II, The American Legion resolved that its post-World War I experiences would not be repeated. The painful memories of disabled men waiting for more than five years for legislation which would permit prompt and fair adjudication of their rights to hospital care and compensation inspired American Legion leaders to work for the enactment of this omnibus law which has been described as the most comprehensive piece of legislation dealing with veterans' affairs ever enacted.

The GI Bill of Rights embodied all that The American Legion had learned during a quarter century and its preparation involved many months of careful research, the analysis of convention mandates, exchange of ideas with experts in the military, naval, educational, financial, employment, and unemployment compensation fields. Of inestimable value in drawing up this legislation were the experience records of the National Rehabilitation Commission of The American Legion. The GI Bill of Rights is best described by its several titles: (1) Hospitalization, claims, and procedures; (2) Education of veterans; (3) Home, farm, and business loans; (4) Employment of veterans; (5) Readjustment allowances for unemployed; (6) General administrative and penal provisions.

The Veterans Administration was made the focus of most operations under the law and the point of contact for the veteran in matters falling under other government jurisdictions. The drafting of this legislation has been called the greatest single feat of statesmanship in the history of The American Legion. The methods by which it was guided through Congress and to the President's desk demonstrated the strong links which bind The American Legion to all segments of American life. Not only was the public made thoroughly aware of the complex content of this Legion-sponsored bill, but the nation's legislators were kept fully informed for several months as to the sentiments of their constituents on the measure.

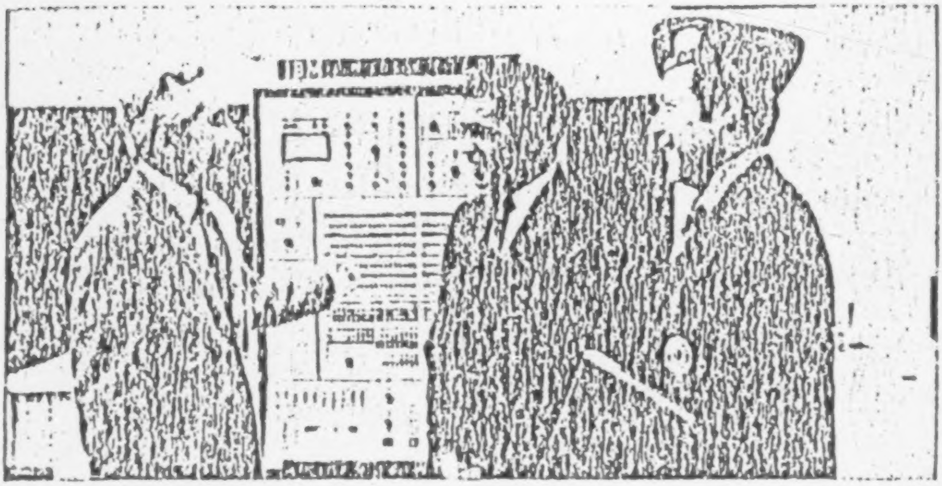
With the commitment of American troops to meet communist aggression in Korea in 1950 and in South Vietnam in 1964, similar programs supported by The American Legion were enacted for the benefit of the veterans of the periods of these armed struggles.



President Franklin D. Roosevelt signs The American Legion-authored GI Bill of Rights for World War II veterans, June 22, 1944. Witnessing the historic event are American Legion leaders and key members of the U.S. Senate and House of Representatives.

VIII. *Economic*

THE ACTIVITIES AND PROGRAMS under the jurisdiction of the National Economic Commission are as old as The American Legion itself. However, these activities and programs were not grouped into one commission



The opening of the decade of the 1970's found The American Legion once again marshaling its resources to assist a new generation of war veterans in finding jobs or the necessary training for skills in demand.

until action was taken by the National Executive Committee in November 1947. The program started when the young World War I veteran, with sixty dollars in his hand, faced the problems of finding a job and a home and meeting the other economic questions facing every man who returns from the service of his country. One of the earliest American Legion economic programs was that of assistance in finding employment. Closely allied with this was the program of obtaining a preference for veterans in federal employment.

The American Legion has for many years advocated certain preference for veterans in federal employment. The passage of the Veterans' Preference Act of 1944 was the culmination of years of hard work by the major veterans' organizations, the Civil Service Commission, and the Committee on Civil Service in both the Senate and House of Representatives.

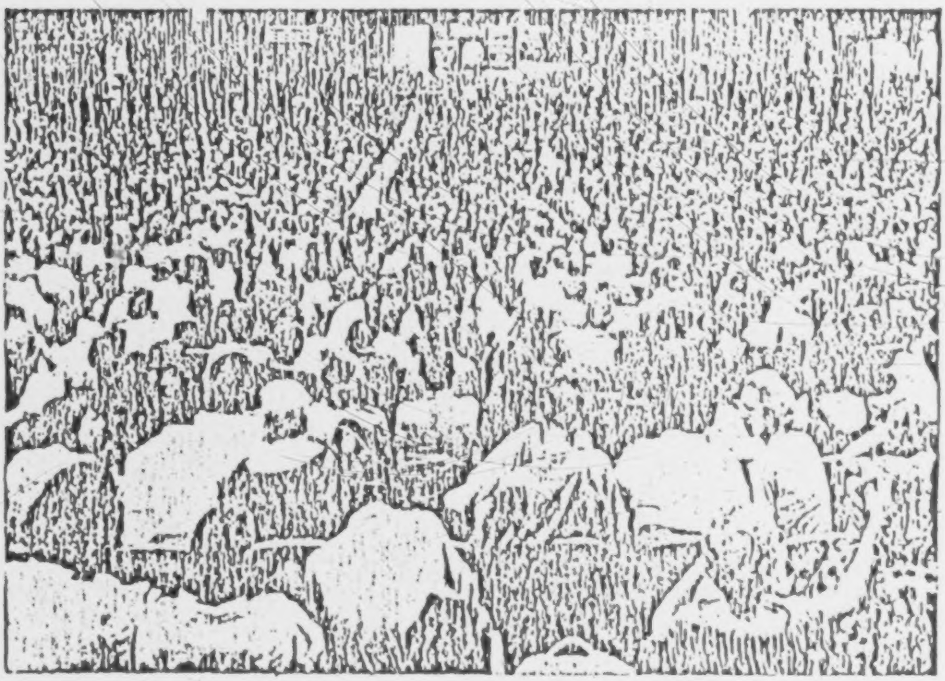
The American Legion has a deep interest in the provisions of the Veterans' Preference Act of 1944, as amended, because this statute was enacted with the Legion's unqualified endorsement and, in fact, The American Legion itself was instrumental in the drafting of the language of this legislative measure. It is interesting to note that this law was enacted with but a single dissenting vote.

In spite of the continued opposition to such preference, The American Legion wrote and had approved the first Executive Order establishing preference by giving five points to veterans and ten points to disabled veterans in competitive examinations for federal employment. Thus, the qualified compensable service-connected veteran was able to get to the top of the certificate of eligibles for federal employment.

Wagner-Peyser Act of 1933

The first legislation which provided federal assistance to veterans in finding employment was included, at the request of The American Legion, in the Wagner-Peyser Act of 1933. This act provided for the development and maintenance of a national system of employment offices to include a veterans' service to be devoted to securing employment for veterans.

The current program for veterans' employment is built around legislation sponsored or supported by The American Legion which provides for effective retraining, job counseling, and employment placement service for veterans. Such legislation also requires employment policies to be promulgated and administered which will provide veterans the maximum of job opportunity.



Typical of American Legion National Convention scenes is this of the opening session of the 1960 conclave at Miami Beach, Florida.

IX. *War Time Service*

AN ORGANIZATION of war veterans, The American Legion has found itself in a position to perform vital services to community, state, and Nation immediately prior to and during subsequent periods of armed conflict.

More than a year before the United States entered World War II, The American Legion began organizing for more effective cooperation with local, state, and national defense activities. In February 1941, a commission was sent to Europe at the expense of The American Legion to study civilian defense under modern war conditions. Heading this commission was then National Commander Milo J. Warner. Upon its return the commission reported at a special meeting of the National Executive Committee and The American Legion published and distributed 150,000 copies of a manual on civilian defense—the first such information to be issued in this country.

After Pearl Harbor, American Legion posts threw themselves into the task of strengthening the homefront to assure victory. The American Legion collected necessary salvage; engaged in a nationwide program of training instructors for air raid wardens, auxiliary police, and firemen; established blood banks; collected cigarettes and gifts for men in camps and overseas; located skilled workers for essential services and industry; cooperated with the Red Cross and the USO; provided entertainment for hospitals at home and operated canteens for men in uniform; staged bond drives and invested post and personal surplus funds in U. S. War Bonds; cooperated with the F.B.I. in helping to check sabotage and espionage; recruited flying cadets and volunteers for the various branches of the armed forces. These and many other services were volunteered by American Legion posts and members. Thousands of American Legionnaires themselves returned to active service with the armed forces and saw action on every front.

For three years prior to the outbreak of hostilities in Korea, The American Legion warned of the spread of communism in Asia and called for a Universal Military Training program to strengthen our Nation in dealing with this problem. However, an America enjoying the first sweet taste of victory and peace after World War II would not heed the Legion's alarm.

Throughout the period of hostilities in Korea, The American Legion supported the measures necessary to bring about a total military victory, but the advocates of political settlement prevailed. The consequences of such a decision are still to be weighed by future historians.

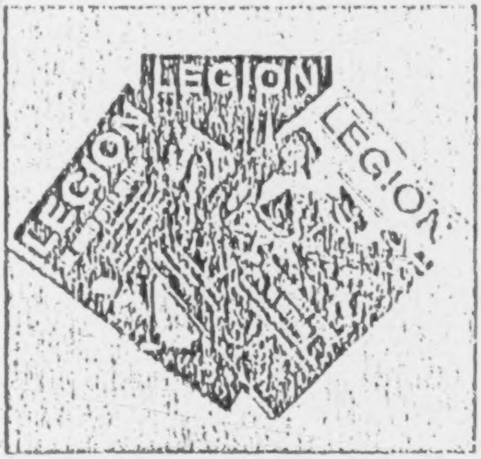
On August 5, 1964, an incident in the Gulf of Tonkin changed the role of the United States in its assistance to the people of South Vietnam. Overnight, U. S. armed forces personnel became more than advisers to South Vietnamese military units, and another generation of Americans answered the call to defend the cause of freedom.

Leading the Nation's expressions of support for the men and women in uniform were American Legion Posts which established elaborate programs of contact with military personnel, providing mail, gifts, and the hospitality of thousands of posts throughout their tours of duty. The Legion also undertook a gigantic program of personal contact to help ease the problems facing the men and women of the armed forces as they returned to civilian life.

X. *American Legion Publications*

THE FIRST VENTURE of the national organization of The American Legion into the publishing field was *The American Legion Weekly*, which made its debut with the July 4, 1919, issue. The weekly was published until June 18, 1926, when it was succeeded by *The American Legion Monthly*. In June 1937, the publication's name was changed to *The American Legion Magazine*, which today ranks as one of the leading magazines in America. This publication goes to every Legionnaire.

In January 1935, there also was established a monthly tabloid, *The National Legionnaire*, which also was sent to every member. This publication was devoted entirely to news of American Legion activities and carried no fiction stories or advertising. After fourteen years as a separate publication *The National Legionnaire* was merged in February 1949, with *The American Legion Magazine.*



The American Legion Magazine which is received monthly by each member of the world's largest veterans' organization is recognized as one of the nation's leading publications.

XI. *American Legion Auxiliary*

ESTABLISHMENT OF A women's auxiliary to The American Legion was provided for by the First National Convention in 1919 at Minneapolis, and when the 1920 Convention opened in Cleveland, Ohio, 1,342 local units had been formed and 11,000 members enrolled under the tentative name of Women's Auxiliary of The American Legion.

Intensive organization followed the Cleveland convention with the number of units being increased to 3,653 and the membership to 131,000 within a year.

The American Legion Auxiliary

MIRIAM JUNGE, *National Secretary*

CHAPTER IV

☆

BIRTH AND GROWTH

NEARLY EVERY MAN in World War I who endured the dangers and lships of camp, ship, and battlefront, there was a woman serving at o help make possible America's victory—his wife, mother, sister or r.

er the war had been won and the men of the armed forces had banded r in The American Legion to carry forward their services to country e time, it was only natural that the women of their families should o continue to serve with them. The result was the American Legion ry, the largest and most influential women's organization of its kind orld today.

establishment of an Auxiliary to The American Legion was pro- or by the first national convention of The American Legion in 1919. time of the 1920 national convention, 1,342 local units of this Auxil- l been formed and intensive organizations efforts were authorized. t national convention of the Auxiliary was held in Kansas City, Mo., , at which time the name "American Legion Auxiliary" was adopted first national officers elected.

Auxiliary grew from a first year enrollment of 121,000 to approxi- 500,000 at the beginning of World War II. After women of World and Korean War families became eligible, the enrollment rose to a record of 1,001,545 in 1955, and since has remained well above ,000 mark. When the eligibility of women of Vietnam Hostilities became a reality, we expanded our horizons on membership. The of local units of the Auxiliary is approximately 13,000. Auxiliary ution, local, state and national, parallels that of The American Legion. y national headquarters are maintained in Indianapolis, Ind., with tional office also maintained at The American Legion building in gton, D. C.

PURPOSE OF THE AUXILIARY

AMERICAN LEGION AUXILIARY has one great purpose, "to contribute he accomplishment of the aims and purposes of The American Except for the addition of those words, the Preamble to its na- nstitution is the same as that of The American Legion.

The American Legion Auxiliary sets up no policies of its own, always following those of The American Legion. Its activities are designed to carry out the parts of The American Legion's program which can best be accomplished by the work of women.

THE AMERICAN LEGION AUXILIARY MEMBER

MEMBERSHIP IN the American Legion Auxiliary is limited to women who have direct personal connection with World War, Korean War, or Vietnam service through a member of their immediate family who served with the Armed Forces during those wars, or through their own service with the Armed Forces. Upon establishment of eligibility, such women may become members of a local unit of the Auxiliary. A member of a local unit is also a member of the state department and the national organization, just as a citizen of Chicago is also a citizen of Illinois and of the United States. By the payment of dues in the local unit a member also contributes to the support of the state and national organizations.

Three Classes of Women Eligible—All women who are eligible to membership in the American Legion Auxiliary come under one or more of the three following classifications:

(a) Mothers, wives, sisters, daughters and granddaughters of members of The American Legion.

(b) Mothers, wives, daughters, sisters, and granddaughters of all men and women who were in the Armed Forces of the United States between April 6, 1917, and November 11, 1918, or between December 7, 1941, and December 31, 1946, or between June 25, 1950, and January 31, 1955; August 5, 1964, to May 7, 1975*, or who, being citizens of the United States at the time of the entry therein, served on active duty in the Armed Forces of any of the governments associated with the United States during either of said World Wars, and died in line of duty or after honorable discharge.

(c) Women who through their own wartime service are eligible to membership in The American Legion.

The only form of membership that is authorized is active membership, of which there are two classes, senior and junior, and there can be no granting of special or honorary membership for any purpose or reason whatsoever.

Once accepted as an American Legion Auxiliary member, women eligible under classification "a" may continue their membership from year to year whether or not their male relative continues to be a member of The American Legion. The fact that her service relative is no longer a member of The American Legion does not compel the Auxiliary member to lose her Auxiliary membership.

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* Congressional action pending to amend Section 5 of the Charter of The American Legion. If adopted, the dates for the Vietnam era will be Dec. 22, 1961 to May 7, 1975.

The term "wife," as used in the eligibility clause, does not necessarily ean that the wife occupied that status at the time her husband was in war rvice. Any woman who marries a member of The American Legion at any me is eligible to membership in the American Legion Auxiliary. The term vife" also includes widows.

An American Legion Auxiliary member eligible through a Legionnaire usband does not lose her Auxiliary membership if she should be divorced. s long as she maintains her membership she is eligible through her former usband, but should she drop her membership she has no eligibility for -enrollment through his service.

At the 1970 National Convention in Portland, Ore., The American Legion larged the eligibility provisions of the American Legion Auxiliary by in-
uding granddaughters. In the 1970-71 year, granddaughters became mem-
rs for the first time. Nearly 100,000 Junior members are enrolled in the merican Legion Auxiliary, many of them granddaughters.

THE AMERICAN LEGION AUXILIARY UNIT

THE BASIC organization of the American Legion Auxiliary is the local unit. All Auxiliary members must hold membership in some local unit. is through the local units that the department and National program is rried into concrete action and through which the American Legion Aux-
iary exerts its power for service to The American Legion and the nation. he primary purpose of an auxiliary unit is to aid The American Legion st to which it is attached in accomplishing American Legion projects in e community. The auxiliary unit is an auxiliary body to The American gion post and takes the post's name and number. A unit can be formed ly under the authority of and in connection with an American Legion st, although under certain conditions the unit may continue to exist after e post to which it is attached has ceased to function.

Ten new senior (adult) members are required to form an American gion Auxiliary unit. The unit must take the name, number and location of he American Legion post to which it is attached, and these appear on the nit charter. When a post changes its name and number, the unit attached that post must also change its name and number to correspond with those the post.

The cancellation or revocation of a post charter does not invalidate the arter of its auxiliary unit. The unit may continue to operate, bearing e name and number of the post to which it was attached. In this status is known as a "widow" unit.

The unit should always remember that it is an auxiliary to its post and first purpose should be to forward the program of the post. It must never ke action which conflicts with the stand of the post and should never dertake an important project without the post's approval. The unit should gard its connection with the post as a distinct honor. It should strive unceasingly to carry out the national constitution's pledge "to participate and contribute to the aims and purposes of The American Legion."

Officers of an American Legion Auxiliary unit corresponds to those of an American Legion post.

President
Vice President
Treasurer
Secretary
Historian
Chaplain
Sergeant-at-Arms

Dues are paid to the unit, which forwards department and National dues to the department headquarters.

AMERICAN LEGION AUXILIARY ACTIVITIES

THE ACTIVITIES of the American Legion Auxiliary are designed to support and supplement the work of The American Legion. They parallel closely and are completely coordinated with the activities of The American Legion. Wherever in The American Legion's program the work of women can be helpful the Auxiliary will be found energetically at work.

NATIONAL HEADQUARTERS

The American Legion Auxiliary maintains its National Headquarters in Indianapolis, Indiana, in a part of the War Memorial Commission Plaza of the State of Indiana. Housed on the third and fourth floors of the state-owned building at 777 North Meridian Street, it is situated across the mall from the National Headquarters of The American Legion. Offices of the three National Officers (the National President, National Secretary, and National Treasurer) and the staff are located there with 14 members of the staff assisting the National Officers.

In addition, the American Legion Auxiliary maintains an office in Washington, D.C. in The American Legion Headquarters there. A Director of that office and secretarial staff complete that branch. The National President and her personal secretary relate themselves to the correspondence of that office and the official itinerary of the National President.

In the National Headquarters office, the National Secretary and her staff correspond with the Departments and National Committees and handle details of National meetings. Inventory of supplies for Departments and committees is also handled in this office. A complete file of Unit Charter information is maintained as well as microfilm records of all membership applications and remittances of memberships. The National Treasurer's office, as its name implies, handles disbursements and the income of the Auxiliary as well as records of membership. A permanent file of the work of the Auxiliary is also maintained in National Headquarters.

The Washington Office handles contacts with government agencies and national organizations with offices in Washington, as well as programming ınce -to National Chairmen, especially the Girls State and Women's ıı on National Security.

onsidering the large membership of the organization, the staff of the onal Headquarters is relatively small. This is to the credit of our Auxil- -and is due largely to three reasons: 1. reliance on the Department ; and staff for much of the detailed record-keeping; 2. concentrated anization of the work of National Headquarters; and 3. appreciated ınce by the program divisions of The American Legion National Head- ers in many instances in any given year.

AMERICANISM

he Americanism work of the American Legion Auxiliary includes all ties tending to perpetuate American ideals and to uphold the principles nerican democracy. The Auxiliary's work is largely educational in nature, aching of good citizenship, loyalty and patriotism. Auxiliary members the American form of government in their Units and strive to make homes centers from which American ideals will radiate. Through their ts with young people they are able to exert wide influence on behalf od citizenship and patriotism.

uxiliary Americanism activities include sponsoring of study classes on onstitution, helping in community observance of patriotic holidays, oring citizenship classes for aliens, presenting flags and flag codes to ls, sponsoring Girl Scout troops, Camp Fire Girl groups, and similar organizations, presenting Americanism awards in the schools, and ıg Americanism meetings and community forums. Citizenship education mphasis on youth-related activities is an on-going thrust.

ginning in 1966, the Auxiliary annually has sponsored a Freedoms lation seminar for graduate study of teachers (with degree credit) ed on Americanism and given by accredited professors at Freedoms lation. Thirty or more teachers each year are awarded scholarships to udy course, each with full expenses paid and each scholarship in the ıt of $550. A continuing part of the total Americanism program is the l sponsorship in all Departments of the Girls State program and the rship nationally of the Girls Nation program. This outstanding pro- in citizenship training is discussed in another section of this book.

CHILDREN AND YOUTH

ıe American Legion Auxiliary's Children and Youth program is com- coordinated with that of The American Legion. Its purposes and ies in this field are the same as those of The American Legion. Much actual work of contacting needy children in their homes and bringing m the necessary aid is carried out by the women of the Auxiliary.

ıe International Human Assistance Programs, which gives assistance to n with heart problems requiring surgery, is a program in Children and

Youth supported by the American Legion Auxiliary without the assistance of The American Legion. Funds raised for this endeavor are divided equally between International Human Assistance Programs, Inc. and the Metropolitan Medical Hospital in Minneapolis, Minnesota where the actual surgery is done. IHAP provides the transportation for the child and an escort.

Important financial support is given by the Auxiliary's national organization to The American Legion's national Children and Youth program. For example, since 1957 an annual contribution of $20,000 has been given to the Children and Youth Division for support of their programs and an additional $10,000 is donated by the Auxiliary to the National Child Welfare Foundation.

COMMUNITY SERVICE

American Legion Auxiliary Units always have been very active in the community service field, every Unit being expected to carry out at least one project for the benefit of its community each year.

Community service projects successfully carried out by the American Legion Auxiliary, either alone or in cooperation with other organizations include:

Community Beautification: beautifying parks, playgrounds, areas around nursing homes, and conducting community clean-up and paint-up campaigns.

Community Health: cooperating with local health authorities, providing community clinics, nurses, drinking fountains, ambulances, hospital equipment such as incubators, training in life-saving procedures, assisting in the removal of architectural and attitudinal barriers facing the handicapped, and aiding local campaigns of national health organizations.

Recreation: helping to provide playgrounds and equipment, swimming pools, youth activity centers, and other recreational facilities.

Safety: cooperating with the National Safety Council in campaigns against accidents on the highways, streets, and in the home.

Community Councils: promoting community service councils composed of all civic, patriotic, and fraternal organizations as the best way of securing community improvements.

EDUCATION

The American Legion Auxiliary works very closely with The American Legion to offer educational opportunities to all people, especially the youth.

The "Need A Lift?" booklet written and printed by The American Legion is highly recommended by the Auxiliary for its value as a research source on scholarships, listed state by state, as a source of informational aid to all students who are looking for career information and guidance pamphlets, and additional information whereby the student can find other subject matter on education quickly and easily. "Need A Lift?" contains information on financial aid programs and loans available through the federal government.

Annually the National President, on behalf of the National Organiza-
n, awards 10 scholarships designated as the National President's Scholar-
ip. These are awarded by areas (geographical designations) with 2
olarships in each area, one for $1,500 and one for $1,000 to a son or
ughter of a veteran. The Eight and Forty, a subsidiary of the American
gion Auxiliary, offers several scholarships annually to a registered nurse
o wishes to extend her knowledge into the field of respiratory illnesses.
formation and pamphlets are available from The American Legion and
nerican Legion Auxiliary on the G.I. Bill, the Jr. G.I. Bill, the Vietnam
. Bill, Social Security and widow's benefits.

The American Legion and the American Legion Auxiliary now have a
rdinated committee composed of key persons, from both organizations,
ose purpose it is to satisfy themselves and the membership that The
gion and Auxiliary are doing all they can to aid the field of education.
ey study the present program to see where improvement is needed and
anges that must be made. The National Coordinated Committee urges Post
Unit participation in a similar committee to better their relationship
th each other and the community in which they reside.

The National Committee is urging all Posts and Units to assist their
nmunities in Career Education by whatever way they can that fits their
ale. The Committee feels that all people cannot get a higher education,
l to have a useful and productive place in society, each individual
ould have instruction and guidance in finding work in their life that is
isfactory to them.

Many local Posts and Units, as well as Departments, have scholarships
ailable to students, and usually the requirement is that the student be a
ld of a veteran. The Legion and Auxiliary supports National Education
eek, awards to students and teachers, and all programs of Americanism
thin the schools. Many pamphlets are available on the Education Program
l can be secured by writing the National Headquarters and requesting
m.

GIRLS STATE

Girls States, similar to The American Legion's Boys States, are sponsored
the American Legion Auxiliary each summer in 50 states, District of
lumbia and Panama Canal Zone. Girls who are attending Senior High
hool and are in the Junior Class are selected for their interest in govern-
nt and potential leadership qualities to attend the Girls State Session—
ying in length from 5 days to 10 days (the decision of the State) and
Girls State as citizens they create and operate a government of their
n. Similarly, from each Girls State session, two citizens are chosen to go
Girls Nation in Washington representing their State as Senators and
Girls Nation they create and operate their own government parallel to
own Federal Government. Each year the opportunity of citizenship
ining through Girls State comes to 25,000 young women in our nation.

JUNIOR ACTIVITIES

The American Legion Auxiliary's Junior members, those under the age of 18, function in all Auxiliary programs, within special activities designed for their age groups. Membership records reflect more than 104,000 daughters, granddaughters, and sisters of Legionnaires in the Junior ranks. Formed into Junior groups within the Units, under the guidance of a Senior Advisor, these young ladies add to the services and community activities of The American Legion and the American Legion Auxiliary and in turn receive training in the organization's work and in good citizenship.

LEGISLATION

The American Legion Auxiliary has no legislative program of its own, devoting its legislative efforts entirely to the support of The American Legion's program. National, department and unit legislative committees are very active in winning public support for American Legion endorsed legislation and in making this support effective in state legislatures and in Congress. American Legion leaders give a generous share of the credit for The American Legion's legislative success to the members of the American Legion Auxiliary. In the past several years, American Legion Auxiliary members have been saluted by The American Legion for their support of and subscriptions to the publication "Legislative Bulletin."

MEMBERSHIP

Like The American Legion, the American Legion Auxiliary carries out a vigorous membership campaign each year. A majority of local units conduct their campaigns during November and December, then continue active membership enrollment through the winter and spring months.

The Auxiliary has published a brochure on the programs of the Auxiliary entitled, "You and the American Legion Auxiliary." You may secure copies of this brochure by writing National Headquarters. The brochure was designed to both educate the membership, as well as an attractive membership promotion item. Also available is a bulletin on membership which originated from the Fiftieth Anniversary observance—this Bulletin explains the operation of the American Legion Auxiliary entitled "Who, What, When, Where and Why"? In addition, the pamphlet "How to Organize a Unit" has been updated and reprinted and is available, also. To assist Units in enrolling new members, a brochure entitled "Have You Met Her?" has been published and is available through Department Headquarters.

MUSIC

Music plays an important part in Auxiliary activities. Units open and close their meetings with patriotic music and have group singing at their meetings and many have organized choral groups who make frequent appearances in American Legion and Auxiliary programs, meetings of other organizations, and on Radio and Television. At some National Conventions and Junior musical contests were held. A Girls State Chorus was a of the 1974 National Convention and in 1975 the sponsorship of l contests was resumed.

NATIONAL SECURITY

the firm belief that the foremost obligation of our country is to provide security of its people, the American Legion Auxiliary works side by ith The American Legion in support of an adequate national defense. merican Legion Auxiliary has always been a powerful moving force h its involvement in programs aimed at keeping America strong—ily, economically, and spiritually. During the years following the 'orld War, when a radical pacifist movement urging the total dis- ent of the United States was claiming support of the women of a, the American Legion Auxiliary campaigned effectively to refute laims. The Auxiliary's effort was a contributing factor in the main- : of a skeleton defense framework during the years between the two Wars.

e American Legion places top priority on national security issues and h mandates at its National Conventions, strives to maintain the y and protect the interests of the United States. The definite objectives national security program of both organizations are outlined annually.

tional Security forums, conferences, and meetings, sponsored by the an Legion Auxiliary at national, state and local levels provide the unity to inform members and the general public of the need for an g nationwide program and the importance of preparedness at all By means of speakers, press, radio and television, the Auxiliary is tly at work to present The American Legion's national security n to the public. Women being the most receptive field for the of sentiments against military training and defensive preparations, nerican Legion Auxiliary is of vital importance in winning women's t for military manpower and defense measures deemed necessary by nerican Legion.

h year, since 1952 through the aid and encouragement of the ry, the Women's Forum on National Security meets in Washington, study and evaluate our nation's needs for preparedness and defense. o this, the Auxiliary for some twenty-six years was a part of the n's Patriotic Conference on National Defense." The purpose of the is to inform, arouse and activate public opinion among women throughout the nation. On alternate years the American Legion ry serves as chairman; while other years another of the 15-member ation assumes responsibility for the annual program. Top government , scientists, educators and other public figures are invited to partici- d share their views on the current status of our national security.

Auxiliary actively supported the men fighting the Vietnam War. han $100,000 was sent by The American Legion and Auxiliary to the

Vietnam Relief Fund as support of the Civic Action Teams. Transistor tape recorders were sent to field hospitals and money was contributed to an orphanage established by American troops as well as numerous other projects. Both organizations joined in a massive letter writing campaign in behalf of prisoners of war and those missing in action. Since the release of POW's in 1973, the campaign has continued in behalf of those unaccounted for and missing in action.

In recent years much emphasis and support has been given The American Legion's Crime Resistance and Law and Order programs by the American Legion Auxiliary to strengthen America at the community level.

FOREIGN RELATIONS

In 1967, the American Legion Auxiliary chartered its first foreign Department, the Philippines. Every other one of its 54 Departments corresponds to one of the 50 states, or two overseas territories (the Panama Canal and Puerto Rico) or the District of Columbia. However it does have local Units in Canada, Costa Rica, France, Germany, Japan, Mexico and the Republic of China.

Auxiliary members, dedicated for service to their community, state and nation, long have promoted community service also among the community of nations. Between World Wars I and II, these efforts were programmed through the Auxiliary's membership in a federation of Auxiliaries to veterans organizations among the Allied Powers known as FIDAC ("Federation Interalliee des Anciens Combattants"). When this federation fell apart at the outbreak of World War II, the American Legion Auxiliary converted its National FIDAC Committee into a National Pan American Study Committee to foster hemispheric solidarity. Each year, beginning in 1941, it focused a national study program on a different one of the member nations in the Pan American Union, its people, language, history, customs, art, music and culture.

In 1956, a voluntary self-help project was introduced into this program. This is funded not by dues but by "seeding monies" raised by interested members and Units of the American Legion Auxiliary. CARE, Inc. serves as its purchasing agent, conveyor belt for supplies and supervisor at the project sites. Labor is provided by citizens of the communities in which these projects have been activated. Since 1956, these self-help projects have burgeoned from an average investment of about $1,500 per annum to around $55,000 per year. Never has the National Organization set a specific goal for its Units to meet. The emphasis is not on dollars, but on collections of pennies, and the power of the penny is self evident in the accomplishments listed below.

In the early 1960's the Auxiliary changed the name of this program to "Foreign Relations" both to conform to the terminology which The American Legion used and to more accurately define its activity as being more than a

program. No longer is it confined to the area of Latin America.
cts vary annually. Here are some examples:

ocational and educational tools have been provided to students in
E, COLOMBIA, COSTA RICA, HAITI, HONDURAS and PANAMA;
eeds and fertilizers to farmers in BELIZE. Earthquake devastation has
repaired in CHILE and GUATEMALA and electric power brought to
es in KOREA. Schools and classrooms have been built in the DOMINI-
REPUBLIC, INDONESIA, NICARAGUA, PERU and the PHILIP-
S; a village sanitation project introduced to EL SALVADOR, and
water projects to BOLIVIA, ECUADOR, KENYA and the PHILIP-
S. Food canning and preservation facilities have been provided to the
INICAN REPUBLIC and GUATEMALA, health clinics to KENYA,
ernity and pediatrics hospital to MALAYSIA and a community center
NG KONG. All of these, and many other projects are still bearing
because once a project is funded, and the peoples have the means with
to help themselves, the American Legion Auxiliary moves on to
r need in another part of the world community. If poverty breeds
hen the Auxiliary is attacking one of war's causes at its source.

POPPY

ne of the most important of the American Legion Auxiliary's activities
supervision of the making and distributing of memorial poppies,
are worn throughout the nation on Poppy Day each year in tribute
war dead. Traditionally, the first poppy is presented to the President
United States.

e poppies are made by disabled veterans of all wars, working in veter-
ospitals in every part of the country and in convalescent workshops
ined by the American Legion Auxiliary. The work is beneficial to
terans both because of the money they earn and because of its value
upational therapy. Approximately 6,000 disabled men are given em-
nt in the program, and about 19,000,000 poppies are made. Manu-
is in charge of the state organizations of the American Legion Aux-
except in a few states where The American Legion directs the program.

Poppy Day, generally observed during the week before Memorial
orkers from American Legion Auxiliary units and cooperating young
's organizations, all of them unpaid volunteers, distribute the poppies
streets of cities and towns throughout the nation. Some 150,000
eers serve each year. Contributions received for the poppies go en-
o the Veterans Affairs and Rehabilitation and Children & Youth funds
American Legion Auxiliary, forming the major source of financial
t for these vast activities. The bulk of the money stays in post, unit
partment treasuries for use in local rehabilitation and relief work
the following year.

"honor the war dead and aid war's living victims" is the purpose of
ppy program.

COMMUNICATIONS

All of the activities that come under the realm of Public Relations for the American Legion Auxiliary with the outside media and some of the activities of inner communications in the organization come under the jurisdiction of the Communications Committee. The largest part of this committee's activities is geared to furnishing to the media (press, radio & television) materials on each of the programs of the American Legion Auxiliary, both locally and nationally.

In the field of press, radio and television, the Departments annually salute local newspapers, radio and television stations for their aid in publicizing the work of the Auxiliary. The Golden Mike and Golden Press Awards were initiated by the American Legion Auxiliary in support of the American Legion's Child Welfare Resolution calling for the emphasis of Juvenile Decency over Juvenile Delinquency in the nation's communication media. The awards are designed specifically to give recognition to the efforts of local broadcasters and newspaper editors and feature writers in presenting programs and articles of outstanding merit "in the interest of youth." They were further designed to encourage members of the media to attain the highest standards in local broadcasting and reporting. The American Legion Auxiliary presents two Golden Mike and two Golden Press Awards nationally each year. The Golden Mike Awards are presented-one to the best RADIO program in the interest of youth and one to the best TELEVISION program in the interest of youth. The Golden Press Awards are presented to the best FEATURE ARTICLE in the interest of youth and one to the best EDITORIAL in the interest of youth.

A Communications Guide Book is made available from the National Headquarters upon request and is designed to be a tool to aid local Communications Chairmen in their publicity assignments.

As another Communications tool, National Headquarters makes available a Poppy Day Booklet containing historical data for the information of the local Unit. A small newspaper entitled POPPY DAY NEWS is also available by the National Organization to assist local Communications Chairmen in publicizing Poppy Day.

VETERANS AFFAIRS AND REHABILITATION

The American Legion Auxiliary's work for the disabled veterans of all wars follows and supplements The American Legion's rehabilitation program. Auxiliary support is given to all American Legion efforts to secure the best of care and just compensation for the disabled, and in addition the American Legion Auxiliary carries out projects which add to the comfort and speed the recovery of these veterans. It is the women of the Auxiliary who do much of the actual contacting and aiding of veterans in the hospitals and in their homes.

One of the finest services of the American Legion Auxiliary is given in the Veterans Administration Hospitals, and Non-VA Hospitals, where vol-

teer-workers, who are especially trained for their tasks, go into the hos-
als regularly, visiting the patients and extending many forms of aid to
m.

Christmas "gift shops" operated by the American Legion Auxiliary in
terans' hospitals bring the joy of Christmas giving to the patients. These
ops, operated by the departments in which the hospitals are located, are
cked with gift articles donated by the Auxiliary. The disabled veterans
ect gifts for members of their families and these are mailed to their
mes, without cost to the veterans and in his name only.

In 1966, a new program which had been developing for several years
s put into action. In an effort to meet the needs of the veteran returning
the community, the American Legion Auxiliary inaugurated a "new"
vice entitled "Field Service Volunteers." This is not actually a new pro-
m but a development of the "personal contact and follow-up service"
ich has been a program of the local units since the inception of the
xiliary. However, changes in medical treatment of patients, benefits to
erans through Social Security and other federal legislation, the establish-
nt of nursing homes, all have pointed to the need to enlarge the pro-
m and establish a basis for training volunteers similar to that used to
in Volunteer Hospital Workers. By action of the 1974 National Con-
tion, a program of Home Service, a community volunteer program
the Veteran and his family, was established.

To facilitate the training of all volunteers in the rehabilitation program
evised "Guide for Volunteers in Rehabilitation" was made available to
membership. This manual includes information, rules and ethics not
y for Volunteer Hospital Workers and Field Service Volunteers but also
VolunTeens, American Legion volunteers and non-affiliated volunteers
ruited by the American Legion Auxiliary.

A pamphlet entitled "The Patient Returns to the Community," a guide
a volunteer service program in the community, was published by the
terans Administration and is an excellent and necessary supplement to the
erican Legion Auxiliary Guide in the development of the Field Service
lunteer program.

The various phases of the rehabilitation program occupy a large portion
the Auxiliary's energies and resources and the work is considered of
mary importance to the American Legion Auxiliary as well as to The
erican Legion.

The Auxiliary invests each year over four million dollars for the welfare
sick and disabled veterans. Hospital Volunteers give 1,600,000 hours of
vice. In addition to this, the National American Legion Auxiliary annually
sents $15,000 to The American Legion for rehabilitation work.

In the fall of 1979, a series of eight Regional Program Conferences
laced the Area Conferences held previously. These American Legion and
xiliary Regional Conferences will facilitate early planning and local
lership development in the following program and service activity areas:

Children and Youth
Americanism
Education
Veterans Affairs & Rehabilitation
Leadership
Membership
Legislative
Public Relations

The basic objectives of these Regional Leadership Conferences, in addition to reducing the cost of attending various conferences, is to encourage attendance by District and Post or Unit leadership and to provide a format wherein an individual could receive instructions in any program of The American Legion or Auxiliary in one weekend. Noted speakers are featured in each of the sections of the conferences.

Departments shall be assigned to the Regional Conferences as follows:

Region #1	*Region #2*	*Region #3*	*Region #4*
Connecticut	Delaware	Florida	Alabama
Maine	D. C.	Kentucky	Arkansas
Massachusetts	Maryland	Georgia	Louisiana
New Hampshire	New Jersey	North Carolina	Mississippi
Rhode Island	New York	South Carolina	Oklahoma
Vermont	Pennsylvania	Tennessee	Texas
	Virginia		
	West Virginia		

Region #5	*Region #6*	*Region #7*	*Region #8*
Indiana	Kansas	Arizona	Alaska
Illinois	Iowa	California	Idaho
Michigan	Minnesota	Colorado	Montana
Missouri	Nebraska	Hawaii	Oregon
Ohio	North Dakota	Nevada	Washington
Wisconsin	South Dakota	New Mexico	Wyoming
		Utah	

PUBLICATION

THE AMERICAN LEGION AUXILIARY has a national publication, *National News of the American Legion Auxiliary,* which goes to all senior (adult) members bi-monthly. Many state and local publications also are issued.

AUXILIARY EMERGENCY FUND

In 1970, as a National President's project (Mrs. H. M. Davidson, National President) and to be a continuing project of the American Legion Auxiliary, there was established an Auxiliary Emergency Fund. This project was originally funded by interest from a part of an estate bequeathed to the Auxiliary by a deceased Auxiliary member, Helen Colby Small from the Department of Wisconsin, supplemented by gifts from individual Auxiliary members and Departments of the Auxiliary is an emergency fund for Auxiliary members to provide temporary financial assistance (said Auxiliary member must have been a member for the immediate past five consecutive years—including the current year). Applications and information are available in the office of the Department Secretary.

AUXILIARY INSURANCE PROGRAM

In 1970, there was also established (after a study of several years), a Life Insurance Program for American Legion Auxiliary members. Periodically, advertisements and application blanks are carried in the NATIONAL NEWS. The program featured a constant, never-increasing premium with the coverage determined by the age of applicant when insurance is first issued (said coverage not to be diminished or canceled by the company). This insurance is available only to Auxiliary members. For information, you should contact the office of the Department Secretary or National Headquarters. This insurance program has been expanded to include an In-Hospital income program and a heart-cancer-stroke insurance program.

CAVALCADE OF MEMORIES

In 1972 at the National Convention, the American Legion Auxiliary created a special section of national headquarters in Indianapolis—known as the Cavalcade of Memories Room. In this area—which encompasses four rooms at National Headquarters, and houses the memorabilia of the 50-year history of the American Legion Auxiliary. Furnishings have been donated by Departments. In 1973, the major renovation was completed and the area was dedicated at the 1973 Department Presidents and Secretaries Conference. It continues to grow with interesting memorabilia.

EIGHT AND FORTY

THE "EIGHT AND FORTY," officially La Boutique des Huit Chapeaux et Quarante Femmes, is a subsidiary organization of the American Legion Auxiliary. Its membership is limited to women who have been members of the Auxiliary for at least three years and who have performed outstanding service in the parent organization. Special projects of the Eight and Forty are the combating of tuberculosis and cystic fibrosis among children.

☆

CHAPTER IV

REVIEW QUESTIONS

THE AMERICAN LEGION AUXILIARY

1—Can a woman whose deceased brother was a veteran of World War II but never belonged to The American Legion become a member of the American Legion Auxiliary?

2—Can the daughter of a Legionnaire, age four, become a member of the American Legion Auxiliary?

3—What are the Auxiliary's "Christmas Gift Shops?"

4—Who makes the Auxiliary's Memorial Poppies and who distributes them?

5—What is the name given to the Auxiliary's annual radio-television awards?

PVA
PARALYZED
VETERANS
OF
AMERICA
CHARTERED BY THE CONGRESS OF THE UNITED STATES

April 9, 1984

The Honorable Fortney H, (Pete) Stark, Chairman
Subcommittee on Select Revenue Measures
House Committee on Ways and Means
1136 Longworth House Office Building
Washington, D. C. 20515

Dear Chairman Stark:

On behalf of the members of Paralyzed Veterans of America, I request your favorable consideration and support for efforts to increase the allowable tax deduction for volunteer mileage. PVA, a congressionally chartered veterans' service organization all of whose members have experienced spinal cord injury or dysfunction, is acutely aware of the importance of volunteer activities and the role they play in the success of non-profit organizations such as ours. The present inequity in the allowable tax deduction deters the involvement of many citizens in participating in worthwhile volunteer endeavors by creating an undue financial burden that is not placed on other segments of society who utilize privately owned vehicles.

On April 12, 1984, the Subcommittee on Select Revenue Measures will be addressing this issue and the American Legion will be presenting testimony supporting the increase in the allowable deduction. PVA strongly endorses the efforts by the American Legion, and we believe they have clearly presented reasonable arguments for removing the present inequity.

During the past several years more and more emphasis has been placed on the role of the private sector to implement support services for our fellow citizens. As the growth and scope of federal programs have been reduced the importance of non-profit organizations and volunteer efforts has continued to increase. With this growing reliance on the activities of private citizens and groups little has been done to enhance and encourage their efforts. The removal of the inequity in the present allowable tax deduction for volunteer mileage would be a clear demonstration that the federal government is supportive of such private efforts and would enable and encourage greater participation by volunteers.

801 Eighteenth St., N.W., Washington, D.C. 20006 (202) USA-1300

The Honorable Fortney H. (Pete) Stark
April 9, 1984
Page Two

Again, on behalf of the members of Paralyzed Veterans of America we request your support to increase the allowable tax deduction for volunteer mileage and ask that you adopt the recommendations of the American Legion and other groups and individuals who support active, volunteer services for fellow Americans.

Sincerely yours,

R. Jack Powell
Executive Director

RJP/dc

cc: E. Phillip Riggin
Director of National Legislative Commission
The American Legion

Joseph E. Miller
Assistant Director of National Legislative Commission
The American Legion

Chairman **Stark**. Thank you very much.

Our next witness is Ms. Sandra Crawford, chairman of the Public Policy Committee of the Association of Junior Leagues.

Ms. Crawford, you have submitted formal testimony. It will appear in the record in its entirety and you may summarize it or add to it in any manner you see fit.

STATEMENT OF SANDRA CRAWFORD, CHAIRMAN, PUBLIC POLICY COMMITTEE, ASSOCIATION OF JUNIOR LEAGUES, INC.

Ms. **Crawford**. Thank you very much, Mr. Chairman.

In addition to being chairman of the Public Policy Committee for the Association of Junior Leagues, I am a past president of the Junior League of Philadelphia, and I do appreciate the opportunity to appear here today.

We are supporting H.R. 2697, sponsored by Representative Mikulski. This legislation recognizes the contributions of volunteers by allowing them to take the same mileage deduction as businesspersons.

We are here today to reaffirm our support of this legislation, as we have done in the last two sessions of Congress because it reflects the association's belief in the importance of volunteer work and recognizes the rising costs incurred by volunteers in providing these services.

In addition to the written testimony, I am also submitting for the record letters from three other major voluntary organizations: Independent Sector; the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America, all in support of the association's statement.

The Association of Junior Leagues is an international women's voluntary organization with 249 individual leagues in the United States representing 150,000 members. During the last year, leagues were involved in more than 2,000 projects in their communities and they raised more than $15 million in fundraisers. This money is raised and is to be used in support of projects such as services for children and their families and for the aged, as well as for programs concerned with the arts, urban conservation, and the environment.

Many of these projects require junior league members to drive a long distance to their volunteer jobs. Junior leagues, like many other organizations, are finding it extremely difficult to recruit volunteers to make a regular volunteer commitment to placements which are far distances from their home. The high cost of gasoline and the inadequate deduction for mileage costs jeopardizes the quality and in some case even the very existence of many vital programs.

Many members in the Junior League of Oakland East Bay who live in the suburbs drive at least 45 minutes each way to their volunteer placement. It is becoming increasingly difficult to obtain volunteers for inner city agencies. Increasing the volunteer mileage deduction would serve as an incentive for volunteer recruitment for these agencies.

In areas where there is little public transportation, the cost of volunteerism can be high. In Knoxville, TN junior league members contribute approximately 25,000 hours of volunteer time each year and drive up to 500 miles a year in order to do their volunteer work. In addition, more than 50 percent of the members are employed either full or part time. They need incentives to maintain that volunteer activity.

In Huntsville, AL where there is no public transportation, volunteer drivers are in great demand and they are very difficult to recruit. Yet, many of the community's vital programs depend upon volunteer drivers, Meals on Wheels, programs for the blind, and programs for youths and families.

The current volunteer mileage deduction also has an adverse effect on the scope of volunteer programs. For instance, the Junior League of Bergen County, NJ reports that it would like to expand its telephone reassurance project for the elderly to include a visitors program for the infirm elderly. However because the league is unable to reimburse its members for mileage costs, it has been unable to recruit such volunteers, and therefore has not been able to begin that part of the program.

Increasing the volunteer mileage deduction, would make it possible for the league to expand this program. Some junior leagues and other voluntary organizations do reimburse mileage costs. However, a reimbursement policy deflects funds from other program areas. An equitable volunteer mileage deduction would make it unnecessary for many agencies to reimburse their volunteers for their mileage costs, thus releasing funds for other areas.

In my own junior league, in relationship to the value of volunteers, our members spent over 300,000 hours on volunteer activities. On the basis of the minimum wage, that represents more than a million dollars worth of volunteer service.

While it is true that an increase in the volunteer mileage deduction might take away funds from the Federal Government, we believe that the contribution that is made and the need therefore not to use public funds to support other services, makes it worth while.

The Association of Junior Leagues is committed to ensuring that volunteerism does not become a luxury for its members or any other member of society. We believe our society would be gravely impaired by the loss of the sense of caring and serving that volunteerism encompasses.

We urge this subcommittee to help the spirit of volunteerism flourish by recommending passage of legislation to make the volunteer mileage deduction equal to that granted a business person. We strongly believe that it is unfair for the Federal Government to place increasing demands on volunteers without providing recognition and support for their work.

Volunteers provide their time without pay to those persons and institutions most in need. We urge this subcommittee to take the leadership on this issue by reporting out H.R. 2697 favorably.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF SANDRA CRAWFORD, CHAIRMAN, PUBLIC POLICY COMMITTEE, THE ASSOCIATION OF JUNIOR LEAGUES, INC.

SUMMARY

The Association of Junior Leagues urges the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means to support H.R. 2697, legislation which would allow volunteers to take the same mileage deduction as that allowed business persons when they use their vehicles for business.

The Association's testimony is supported by the Independent Sector, the National Assembly of National Voluntary Health and Social Welfare Organizations, Inc. and the United Way of America.

I. The Association

A. International women's voluntary organization

B. 249 Junior Leagues; 150,000 individual members in the United States

C. Promotes the solution of community problems through voluntary citizen involvement, and trains Junior League members to be effective voluntary participants in their communities

II. Volunteer Mileage Deduction Should Be Computed on the Same Basis as Deduction Provided Business Persons

A. Volunteers such as Junior League members contribute many hours to a wide range of valuable community projects, often traveling long distances to their volunteer assignments. The low mileage deduction allowed to volunteers is especially detrimental to the elderly--many of whom wish to volunteer but are living on a fixed income which restricts their financial activities.

B. The high costs of operating a car and the Internal Revenue Service's refusal to allow volunteers an adequate deduction for mileage costs have forced many volunteers to reduce their volunteer commitment, thus jeopardizing the existence of vital community projects.

C. Denying volunteers the same mileage deduction as that granted business persons indicates that government does not consider volunteers' services to be of equal value to those provided by paid employees. It seems especially contradictory and counterproductive for the Administration to oppose equalizing the mileage deduction for volunteers and business persons at a time when the government is trying to stimulate volunteering.

D. It is especially important at this time of federal funding cutbacks that government policies encourage, not discourage volunteer work.

I am Sandra Crawford, of Gladwyne, Pennsylvania, chairman of the Association of Junior League's Public Policy Committee and a past president of the Junior League of Philadelphia. I appreciate this opportunity to appear before you today to express the Association's strong support for H.R. 2697, sponsored by Representative Barbara Mikulski (D-MD) and 78 co-sponsors, legislation which would recognize the contributions of volunteers by allowing them to take the same mileage deduction as that allowed business persons when they use their private vehicles for business. We are here today to reaffirm our support of this legislation -- as we have done in the last two sessions of Congress -- because it reflects the Association's belief in the importance of volunteer work and acknowledges the rising costs incurred by volunteers in providing their services.

We are pleased that the Select Revenue Measures Subcommittee is holding these hearings, allowing discussion of this important issue. I also am submitting for the record letters from three other major voluntary organizations, Independent Sector, the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America, in support of the Association's statement.

Junior League Volunteers

The Association of Junior Leagues is an international voluntary organization with 249 member Leagues in the United States, representing approximately 150,000 individual members. Junior Leagues promote the solution of community problems through voluntary citizen involvement and train their members to be effective voluntary participants in their communities. Every active Junior League member must make a commitment to a volunteer position. In addition, Junior Leagues develop projects and raise funds for community programs. During 1982-83, Junior Leagues sponsored 2,123 projects in their communities and netted more than $15 million from various benefits and ongoing money raisers such as thrift shops, cookbooks, auctions, and sponsorship of cultural and sporting events.

The money raised by these Junior League fundraisers is used to support projects in the community such as services to children and their families, adolescents, the aged and populations experiencing special problems, e.g., drug abusers, alcoholics and battered women, as well as programs concerned with the arts, urban conservation and the protection of the environment. These programs are made possible by Junior League volunteers who often drive long distances to their volunteer jobs.

Junior Leagues, like many other volunteer organizations, are finding that their members are increasingly reluctant to make firm commitments to regular volunteer placements which are many miles from their homes. High gasoline costs and the refusal of the Internal Revenue Service to allow volunteers an adequate deduction for mileage costs in computing their federal income taxes jeopardize the quality and, in some cases, the very existence of many vital programs. The following experiences reported by some individual Leagues illustrate the problem created by the current volunteer mileage deduction.

In some areas of the country, many Junior League members live in suburban areas, while many of the programs requiring volunteer support are in the inner city. For instance, it is not uncommon for a member of the Junior League of Oakland-East Bay to drive 45 minutes each way to her volunteer placement. Increasingly, the Oakland-East Bay League reports that its members who live in suburban areas are reluctant to accept placements that require driving long distances. This creates difficulties for obtaining volunteer assistance for inner city agencies. Increasing the volunteer mileage deduction would help serve as an incentive for volunteer recruitment for these agencies.

In areas where there is little public transportation the cost of volunteering can be high. For example, members of the Junior League of Knoxville contribute approximately 25,000 hours of volunteer time each year in a city, which like many in America, does not have an extensive public transportation system. Consequently, each Knoxville Junior League member drives an average of 550 miles a year for her volunteer work. Further, approximately 50% of the active members of the Junior League of Knoxville are employed full or part time; they need an incentive to maintain their volunteer activities.

The current volunteer mileage deduction also has an adverse effect on the scope of volunteer programs. For instance, the Junior League of Bergen County, New Jersey, reports that it would like to expand its telephone reassurance project for the elderly to include a visitors program for the infirm elderly. However, because the League is unable to reimburse its members for mileage costs, it has been unable to recruit enough volunteers to launch its visitors program. Increasing the volunteer mileage deduction would make it possible for the League to expand this program. Some Junior Leagues and voluntary agencies do reimburse their volunteers for their mileage costs. A reimbursement policy, however, deflects funds from other project areas. An equitable volunteer mileage deduction would make it unnecessary for many agencies to reimburse their volunteers for their mileage costs, thus releasing needed funds for other services.

Faced with the high cost of driving, a volunteer also may cut her involvement with a program from once or twice a week to once every two weeks or even once a month. This could harm programs such as Meals on Wheels or tutoring programs which require brief but frequent time commitments. In fact, the difficulty in recruiting and keeping volunteers for the Meals on Wheels programs served as the catalyst for passage of Colorado's volunteer mileage deduction legislation.

When the Junior League of Denver sought a sponsor for the legislation in 1981, it turned to a State Representative whose blind mother receives deliveries from Meals on Wheels. At that time, the Meals on Wheels program in Greeley was having difficulty recruiting volunteers because of the cost of driving and the low mileage deduction allowed volunteers. The Representative could not travel to Denver to attend sessions of the legislature unless her mother, who lives alone in Greeley, received her meals. Knowing firsthand the importance of the volunteer mileage deduction, the state legislator agreed to sponsor the legislation.

The decline in the number of drivers for Meals on Wheels also was a factor in the decision of the Volunteer Bureau of Des Moines, assisted by the Junior League of Des Moines, to launch its successful campaign for passage of state volunteer mileage deduction legislation in 1981. Junior Leagues in Arkansas, North Carolina and Maryland also supported the passage of volunteer mileage legislation in their states. The Junior League of Portland, Oregon, and the National Council of Jewish Women organized support for volunteer mileage deduction legislation in Oregon, but the bill was not reported out of committee.

Volunteers Should Receive Equal Consideration

The mileage deduction allowed volunteers is based on what the Internal Revenue Service considers out-of-pocket expenses, i.e., gasoline and oil. The mileage deduction allowed business persons, however, is based on the computation of the average costs of depreciation, maintenance, repairs, tires, gasoline and its related taxes, motor oil, insurance and registration fees. Currently, business persons are allowed a deduction of 20 cents per mile. Volunteers, however, are only allowed to deduct nine cents per mile. Recently, the Senate Finance Committee approved a measure which would increase the volunteer mileage deduction to 12 cents a mile. While we welcome the Senate Finance Committee's action, we do not believe it is sufficient. Volunteers, as a matter of equity, should receive a mileage deduction equal to that granted business persons.

The Department of the Treasury refuses to approve equalizing the deductions because it considers volunteers' automobiles primarily personal vehicles; it refuses to allow consideration of a proportionate share of general maintenance, general repairs, depreciation or fixed costs, such as insurance or registration fees, in computing the volunteer mileage deduction. We do not think this is fair. As a matter of equity, we believe the mileage deduction should be computed in the same manner for volunteers and business persons.

Incentive for Volunteering Needed

There is a great need for incentives for volunteering -- a recognition that volunteering is important to society. The volunteer mileage deduction legislation being considered by this committee today is important because it promotes voluntarism by permitting volunteers who use their private automobiles for charitable activities to receive the same tax deduction that business persons receive. The refusal to allow volunteers the same mileage deduction as that granted business persons not only is a failure to focus on the actual costs of operating a car such as wear and tear on the tires, engine and exhaust system; it also indicates that the government does not consider the services of volunteers as important to society as those provided by paid employees. We believe the government's refusal to grant volunteers the same mileage deduction as that allowed business persons is totally inconsistent with the Administration's stated policy of encouraging voluntarism.

Some justify the IRS position by pointing out that government officials and business persons pay taxes on the salaries they earn while using their cars. However, volunteers make an equally important contribution to society: they provide their time without pay to those persons and institutions most in need. Discouraging volunteer work with such policies as refusing to increase the volunteer mileage deduction will only lead to increased costs for the public sector if it must assume responsibility for services now provided by unpaid volunteers. It is especially important at this time of massive cutbacks in federal funding for social services, the arts and education that volunteers be encouraged, not discouraged, to contribute their valuable services.

It is true that increasing the volunteer mileage deduction would take away some revenue from the federal budget. The Association's response to this argument is that the cost of the volunteer mileage deduction is far outweighed by the value of the contributed time. Last year, for example, the members of my Junior League - the Junior League of Philadelphia - contributed approximately 300,000 volunteer hours. At the minimum wage, this contribution was worth more than one million dollars -- certainly a great deal more than the amount of tax revenues that would be lost because of the volunteer mileage deduction.

High Costs of Operating a Car

Although the price of gasoline has dropped in the last year, the rate set for the volunteer mileage deduction by the IRS is still lower than the estimates of operating costs provided by the American Automobile Association (AAA). The AAA estimates the operating costs to be 25.9 cents per mile for a six-cylinder standard car which is driven 15,000 or more miles per year. The cost per mile rises if the car is driven less--as many cars are. For example, the cost per mile for the same car would be 34.5 cents per mile if it is driven 10,000 miles a year.

Use of Automobile

We also question the government assumption that all cars used for business or government purposes are solely business vehicles. Persons with part-time jobs may have purchased their cars well before becoming employed, yet all their business driving is calculated at the higher mileage deduction rate allowed business persons.

Furthermore, the Internal Revenue Service's policy regarding the volunteer mileage deduction discriminates against the volunteer who is not employed outside the home--housewives or retired persons of both sexes.

Elderly persons on fixed incomes especially are adversely affected by the nine cent volunteer mileage deduction. For instance, the director of the Colorado Office of Voluntarism, which operates under the aegis of the governor's office, reports that the activities most directly affected by the refusal of the IRS to raise the volunteer mileage deduction are the Senior Volunteer, Foster Grandparent and Senior Companion programs. Many of the participants in these programs are eager to volunteer; giving of their time to assist others provides them with a sense of accomplishment and a meaningful way of using their empty hours. However, the low mileage deduction often makes it impossible for them to accommodate volunteering into their limited budgets.

We know, from the Association's experience with Volunteers Intervening for Equity (VIE), a national project that organized and trained older volunteers for community service, that retired persons make effective, caring volunteers. In turn, volunteering gives them a sense of accomplishment and being needed by their communities.

I also know from my own experience, as a member of the Board of Directors of the Southeastern Pennsylvania Red Cross, that the low volunteer mileage deduction adversely affects the elderly volunteer. The increased number of working women has caused the Southeastern Pennsylvania Red Cross to recruit retired persons for day time volunteer activities such as teaching first aid courses and driving volunteer blood donors to the bloodmobiles. However, because many elderly persons are living on small fixed incomes, they cannot afford to pay their mileage costs. Consequently, services sometimes are not provided and/or are restricted, because volunteers are not available; some of the Southeastern Pennsylvania Red Cross's ten branches only have bloodmobile activities once every several months. This is a growing problem that threatens to weaken the Red Cross activities throughout the large five county area served by the Southeastern Pennsylvania Red Cross.

The experience in Colorado with the volunteer mileage deduction also highlights the need for the deduction among all volunteer groups. Colorado's legislation is restricted to those volunteering in health, nutrition or medical endeavors. These volunteers are allowed to deduct an additional 11 cents per mile from their Colorado state income tax. The Office of Volunteers in Colorado reports that the volunteer campground groups, which act as hosts at the state parks, are having difficulty in recruiting volunteers. Prospective volunteers for the campground programs hesitate to pledge their time because of the high cost of traveling long distances coupled with the fact that the state mileage deduction is not available to them.

The Junior League of Denver also cites an adverse effect on volunteers in education. There has been a drop in school volunteers, especially in low-income areas and in urban areas such as Denver where mothers must drive across town to reach their children's schools. Today's high cost of living makes it necessary for many parents of young children to live on very tight budgets which allow little room for the costs of volunteering.

Last year, when we appeared before the Senate Finance Committee, we cited a question posed by the Junior League of Eugene, Oregon, at a meeting of Junior Leagues in the northwest. We think that statement is still relevant:

> Will...voluntarism become a luxury that many of our members can no longer afford? Even as we sit here today we are confronted with the fact that our hours of labor donated to our communities are not evaluated on the same plane as the hours of labor put in by the businessman or businesswoman. While we altruistically give of our time the businessperson's time yields monetary gains. Mileage incurred on our "job" may be deducted at 9 cents per mile while the businessperson deducts 20 cents per mile. Child care comes straight from the pocket of the volunteer with young children while the businesswoman takes a tax credit for child care expenses incurred during her work day...

The Association of Junior Leagues is committed to ensuring that voluntarism does not become a luxury for its members or any other member of our society. We believe our society would be gravely impaired by a loss of the sense of caring and serving that voluntarism encompasses. We urge this subcommittee to help the spirit of voluntarism flourish by recommending passage of legislation to make the volunteer mileage deduction equal to that granted a business person. We strongly believe that it is unfair for the federal government to place increasing demands on volunteers without providing recognition and support for their work. An adjustment in the volunteer mileage deduction is long overdue. We urge this subcommittee to take the leadership on this issue by reporting out H.R. 2697 favorably.

Thank you for this opportunity to appear before you today.

Sandra Crawford

Chairman, Public Policy Committee

The Association of Junior Leagues, Inc.

THE NATIONAL ASSEMBLY
OF NATIONAL VOLUNTARY HEALTH AND SOCIAL WELFARE ORGANIZATIONS, INC
1346 Connecticut Avenue, N.W. • Suite 424A • Washington, D.C. 20036 • (202) 296-1515

Attachment I

BOARD OF DIRECTORS
Betty F. Pilsbury, *President*
Donald M. Payne, *Vice President*
Walter L. Smart, *Secretary*
The Rev. Thomas J. Harvey, *Treasurer*
Joyce M. Black
Hamp Coley
Victor T. Ehre
Deborah L. Seidel
John S. Griswold
John H. Loeb
Norman S. Marshall
Florence Moore
Richard F. Schubert
William G. Whyte
Sara-Alyce P. Wright
Leonard W. Stern, *Executive Director*

April 5, 1934

The Honorable Fortney H. (Pete) Stark
Chairman, Subcommittee on Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth Building
Washington, D.C. 20510

Dear Mr. Stark:

The National Assembly of National Voluntary Health and Social Welfare Organizations, Inc., on behalf of its 31 members who provide services to over 50 million Americans and utilize over seven million volunteers, strongly supports the position of The Association of Junior Leagues regarding H.R. 2697. This legislation is important because it would permit volunteers who use their private automobiles to drive for charitable organizations to receive the same standard mileage deduction rate now allowed for business.

Everyone would agree that the work of volunteers in not only vital but essential to our society. Volunteers save taxpayers thousands of dollars by performing services which would otherwise have to be provided by the government. They contribute time which has been estimated to be valued at $64.5 billion each year.

With the ever increasing cuts in federal funding in the areas of health and welfare services, continued reliance on our nation's volunteers will only increase. Many of our agencies, such as the National Board, YWCA of the U.S.A., Travelers Aid Association of America, American Red Cross, Girl Scouts of the U.S.A., in addition to The Association of Junior Leagues, support and have been working to seek passage of this legislation.

It is our view that the proposed revision to the Internal Revenue Code will encourage people to volunteer their services. It is a simple issue of equity, and we urge its enactment.

Sincerely,

Leonard W. Stern
Executive Director

LWS/mbu-w

AFL-CIO, Dept. of Community Services
American Council for Nationalities Service
American Foundation for the Blind, Inc.
American Red Cross
Association of Junior Leagues
Big Brothers/Big Sisters of America
Boys' Clubs of America
Boy Scouts of America
Camp Fire, Inc.
Child Welfare League of America
Council of Jewish Federations
Girls Clubs of America, Inc.
Girl Scouts of the U.S.A.
JWB (Jewish Welfare Board)
Lutheran Council in the U.S.A., Division of Mission and Ministry
National Committee for Adoption
National Conference of Catholic Charities
National Council of Negro Women
The National Council on the Aging, Inc.
National HomeCaring Council
The National Network of Runaway and Youth Services, Inc.
National Youth Work Alliance
The Salvation Army
Travelers Aid Association of America
United Neighborhood Centers of America, Inc.
United Seamen's Service, Inc.
USO (United Service Organizations)
United Way of America
YMCA of the U.S.A.
YWCA of the U.S.A., National Board

Attachment II

United Way
of America

701 North Fairfax Street
Alexandria, Virginia 22314-2045
Phone 703—836-7100

April 9, 1984

Honorable Fortney H. Stark
Chairman
Subcommittee on Select Revenue Measures
Committee on Ways and Means
1034 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

United Way of America strongly supports the position of the Association of Junior Leagues regarding H.R. 2697. Our Government Relations Committee and Board of Governors passed a resolution stating our continued support for legislation making the volunteer mileage deduction equal to that allowed for business. The importance of remedying this disparity was also raised by the member 1,200 United Ways around the country through our issue identification process.

As we have written to this committee before, "we believe the Department of Treasury is wrong to exclude proportionate shares of general upkeep from the charitable mileage allowance . . . . Wear and tear on tires, engines and exhaust systems of cars are directly related to the miles traveled in the course of providing voluntary services and, therefore, should be included in the mileage allowance."

We urge the committee to report out this legislation favorable, both because it would spur on additional volunteering and because it is a public policy acknowledgement that volunteering is a highly valued service.

A list of the members of the United Way of America Board of Governors is attached.

Sincerely,

Jack Moskowitz
Senior Vice President
Federal Government Relations

JM/pel

Enclosure

United Way of America
United Way Plaza
Alexandria, Virginia 22314-2088
(703) 836-7100

OCTOBER 1983

OFFICERS
BOARD OF GOVERNORS
UNITED WAY OF AMERICA

CHAIR:

*Robert A. Beck (1986)
Chairman and Chief Executive Officer
The Prudential Insurance Company of America
Prudential Plaza
Newark, New Jersey 07101
(201) 877-7888

VICE CHAIR:

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ATTACHMENT #3

INDEPENDENT
SECTOR

April 10, 1984

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Vice Chairperson
M. William Howard
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Faye Wattleton
Harold H. Wilke
Sara-Alyce Wright
Adam Yarmolinsky

Ms. Deborah Seidel
Executive Director
Association of Junior Leagues
825 Third Avenue
New York, NY 10022

Dear Deborah:

INDEPENDENT SECTOR strongly endorses the testimony of the Association of Junior Leagues on H.R. 2697 which would provide that the amount of the charitable deduction allowable for expenses incurred in the operation of a motor vehicle will be determined in the same manner that taxpayers determine reimbursement for use of their private vehicles in business activities.

The need for this legislation is clear. Recent cuts in federal funding make it critically important that Americans be encouraged to volunteer their services. However, voluntary organizations are facing serious problems in recruiting volunteers to perform services which require those volunteers to use their private automobiles. The problem cited, is the cost to volunteers of using their automobiles. A Montgomery County, Maryland report, December 1979, gives specifics on this problem. It documents reduced volunteer involvement in services such as daycare centers, boys' homes, nursing homes, handicap facilities and similar organizations. The same report cites a University of Maryland agency as follows: "We have noticed a dramatic decrease in willingness of volunteers to make trips to provide services." I am attaching a copy of the Montgomery County report.

Another organization, VOLUNTEER: The National Center for Citizen Involvement, which has the pulse of the status of volunteering throughout America, states the following: "...Gasoline prices have already caused a cutback in many volunteer programs which require the use of a car. If this legislation is not passed, future increases in fuel cost will force even more volunteers to give up their work."

A NATIONAL FORUM TO ENCOURAGE GIVING, VOLUNTEERING AND NOT • FOR • PROFIT INITIATIVE
1828 L Street, N.W. • Washington, D.C. 20036 • (202) 223-8100
SUCCESSOR TO THE COALITION OF NATIONAL VOLUNTARY ORGANIZATIONS AND THE NATIONAL COUNCIL ON PHILANTHROPY

The nine cents per mile tax deduction permitted by current law to taxpayers who use their cars for volunteer work is wholly inadequate. The American Autombile Association estimates per mile driving costs to be 32¢ for those who drive under 10,000 miles per year and 24¢ for motorists driving 15,000 miles per year.

Volunteers contribute time which is valued at $63 billion each year. More than 84 million Americans volunteer each year in this nation. In view of the recent cuts in federal funding of human service programs, it is exceedingly important that everything possible be done to continue to encourage people to volunteer their services. We strongly urge that volunteers be permitted the same deduction (currently $.20 a mile) for the use of their private automobiles in carrying out volunteer activities, as businesspersons are permitted in using their private vehicles on business.

Sincerely,

Brian O'Connell
President

BO'C/lso

Attachment

VOLUNTEER TRANSPORTATION IN MONTGOMERY COUNTY, MARYLAND

A REPORT

Marit Thorson
Coordinator
Volunteer Services
Office of Family Resources
301 E. Jefferson St.
Rockville, Maryland 20850

December, 1979

ACKNOWLEDGEMENTS

This report would not have been completed without the help of two research and legislative volunteer aides, Virginia Heffernan and Gail Ewing,who completed the tabulations, set up the charts and contributed ideas for the narrative. I am grateful to them for their assistance and to Barbara Gross, Administrative Aide, for typing the report many times over.

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VOLUNTEER TRANSPORTATION SURVEY REPORT

Montgomery County Executive Charles W. Gilchrist late last spring became concerned about the availability of gasoline for volunteers in various County departments who provide emergency or essential service to citizens of the County. These included the Fire and Rescue Department; Civil Defense and Emergency Planning, Health and Social Services and the Office of Family Resources, Volunteer Services. The Executive also reviewed such essential services provided by Meals on Wheels, HELP and FISH groups and others in the private sector that could be adversely affected by gasoline shortages.

Therefore, the Executive asked Volunteer Services to determine what impact the then current crisis and foreseeable future ones would have on volunteer recruitment efforts of voluntary agencies and religious groups as well as of government departments. Montgomery County Public Schools were included in the survey as part of County Government. Volunteer Services was also interested in the scope of volunteer involvement in the County. Hence the first part of the survey questionnaire addressed itself to the number of volunteers and the average number of hours contributed monthly in all three groups.

A survey questionnaire was sent to 382 groups in the three areas known to Volunteer Services as having volunteer programs. Attachments I and Ia are copies of the cover letter and the questionnaire. Ninety-four surveys were returned, representing 25% of the total surveys sent. Nine religious groups reported, a 5% return; 51 private groups responded, a 32% return; and 34 government groups responded for an 85% return.

The two charts following show summaries of the findings from the reported data.

Chart I

MONTGOMERY COUNTY, MARYLAND
VOLUNTEER TRANSPORTATION SURVEY REPORT

SCOPE OF VOLUNTEER EFFORT

TOTAL NUMBER OF GROUPS SURVEYED - 382		TOTAL NUMBER REPORTING - 94	PERCENTAGE OF TOTAL - 25%
Religious	182	9	5%
Private Sector	160	51	32%
Government	40	34	85%

	RELIGIOUS	PRIVATE	GOVERNMENT	TOTAL
Total Volunteers Reported	751	5,938	10,757	17,446
Total Vol. Hours/Mo. Reported	6,336	67,459	181,126	254,921
Total Value of Volunteer Work Per Month for All Three Groups (based on average $4.76 per hour established in 1976 by Wolozin study at State University of Pennsylvania)				$1,213,424
Total Value Per Year				$14,561,088

Estimated Total Volunteer Population (Reporting and Non-Reporting Groups)*

Religious	Private	Government	
18,000	18,556	12,600	49,156

Estimated Total Volunteer Hours/Per Month (Reporting and Non-Reporting)	688,184
Estimated Total Value of Volunteer Work Per Month (Reporting and Non-Reporting) (Based on 14 hours per volunteer per month average)	$3,275,756
Per Year	$39,309,072

*The number of volunteers was projected to estimate the 100% of the volunteer population in each category.

Chart II

MONTGOMERY COUNTY, MARYLAND
VOLUNTEER TRANSPORTATION SURVEY REPORT
PERSONAL VEHICLE MILEAGE USAGE

TOTAL NUMBER OF GROUPS SURVEYED - 382		TOTAL NUMBER REPORTING - 94	PERCENTAGE OF TOTAL - 25%
Religious	182	9	5%
Private Sector	160	51	32%
Government	40	34	85%

	RELIGIOUS	PRIVATE	GOVERNMENT	TOTAL
Total Vol. Mileage/Mo. Reported*	41,340	153,408	299,882	494,630 miles
Total, Vol. Mileage/Mo. Reported for Direct Service**	31,060	127,294	172,534	330,888 miles
Total Value of Mileage/Mo. Reported (based on government allocation of 18.5¢ per mile)	$ 7,647.90	$28,380.48	$55,478.17	$91,506.55
Total Value of Mileage/Mo. for Direct Service (based on 18.5¢ per mile)	$ 5,746.10	$23,549.39	$31,918.79	$61,214.28

* These figures represent mileage to and from the work place, as well as administrative mileage for board/commission meetings.

** These figures represent mileage in transporting others as part of the volunteer's job.

The first chart breaks down the reported totals and average monthly hours for each volunteer in the three groups. There is also an estimated dollar value for volunteer work for all reported volunteers, per month and per year.

In addition, the chart shows the estimated total of reported and not reported volunteers, their monthly hours and estimated dollar value in contributed work.

The second chart is a report on volunteer driving. It is broken down into two parts. One shows the reported total mileage of all volunteers, including their driving to and from the work place. The second part reports the amount of miles driven in direct service of transporting clients.

Supplemental breakdowns of these two sections for religious groups, private agencies and government departments are shown in Attachments I, III, and IV.

Parenthetically, the greatest number of government volunteers are found in the Department of Recreation with 1,868 reported volunteers in their programs division. The Community Action Agency in the Office of Family Resources records one volunteer averaging 1,051 miles per month. The Department of Social Services reports an average of 510 miles per month for thirty-one volunteers each. Direct services driving ranges from 20 miles per month to 1,051 with the majority cluster in the 65 - 95 miles range.

The survey also asked each agency for information on purposes of the direct service personal vehicle use. Services essential to the well-being of citizens ranked highest. Social Services, hospitals, clinics, food and meals for the elderly and friendly visiting ranked high in all sectors. Many government agencies like the Department of Corrections and the Department of Recreation perform different types of service which are reflected in a high percentage of meetings, training, recreation and court visits for their volunteer driving purposes. The total response is shown in the next chart.

TRANSPORTATION SURVEY

TYPES OF DIRECT SERVICES PROVIDED USING OWN VEHICLES

Government: 34 Reporting

Meetings	12	35%	Courts	4	12%
Recreation	6	18%	Social Service	3	9%
Training	6	18%	Hospitals	2	6%
Clinics/MDs	6	18%	Friendly Visiting	2	6%
			Shopping	2	6%

Miscellaneous: Library; Tutoring; Police; Public Speaking; PR; Sr. Citizens Luncheons

Private Sector: 51 Reporting

Social Service	18	35%	Shopping	13	25%
Friendly Visiting	17	33%	Recreation	13	25%
Hospital	14	27%	Rehabilitation	11	22%
Clinics/MDs	13	25%	Training	6	12%
			Meals on Wheels	6	12%

Miscellaneous: Moving; Furniture; Employment; Housing; Mental Health; Voters Registration; Tutoring; Police

Religious: 9 Reporting

Friendly Visiting	6	67%	Shopping	4	44%
Training (Rel. Ed.)	5	56%	Social Service	4	44%
Hospitals	4	44%	Clinics	3	33%
			Recreation	3	33%

Miscellaneous: Transportation to church; Administrative Meetings; Tutoring

Another question referred to reimbursement policies. Few agencies or government departments have budgeted funds for this type of volunteer benefit. Some government departments, however, reimburse direct service drivers on request, and some County boards and commissions have money allocated for meeting purposes. These reimbursements are not reflected in the reported figures.

In order to develop data concerning current income tax mileage deduction practices, the survey provided an optional question. Response was scanty. From the reported evidence, few persons take a mileage deduction at the present rate of seven cents a mile.

Finally, the survey asked for an expression relating to an increase of the present IRS deduction allowance of seven cents a mile for volunteer driving to 17 cents a mile (now increased to 18.5¢ a mile) which is the allowed business deduction. Answers to this question are of importance to legislators at the federal and state levels. There are currently bills in the U.S. House and Senate which would increase the volunteer deduction rate to that of the business deduction rate. A large majority favored such an increase. The next chart gives a breakdown of responses for reimbursement policies, deduction practices and tax policy.

Chart III

MONTGOMERY COUNTY, MARYLAND
VOLUNTEER TRANSPORTATION SURVEY

REIMBURSEMENT POLICY

RELIGIOUS:	No reimbursement for volunteer drivers
PRIVATE SECTOR:	9 agencies, or 18%, reimburse on request or as a policy for all volunteer drivers Range: 10¢ to 25¢/mile. Average: 17¢/mile
GOVERNMENT:	6, or 15%, reimburse on request, County rate: 18.5¢/mile

MILEAGE DEDUCTION PRACTICES

	Agencies Reporting	Total Individuals Deducting
RELIGIOUS	4	117
PRIVATE SECTOR	13	581
GOVERNMENT	5	36

TAX POLICY

Favor 17¢/mile tax deduction		Favor less than 17¢/more than 7¢	
Religious	5	Religious	1
Private Sector	50	Private Sector	7
Government	21	Government	3

Comments on the impact of the gasoline crunch on human services and legislative action desired follow.

TYPE OF AGENCY	COMMENTS
Rehabilitation Service for Handicapped	"Encourage (legislative) representatives to vote for increase to 17¢. Volunteers are careful about driving."
A Boys Home	"Retention of volunteers would be easier if reimbursement were available or a larger deduction were allowed."
A Girls Home	"In favor of any legislation to enable volunteers to defray driving expenses."
Day Care Center	"Hard to get volunteers to drive. (Cars) needed for job and family necessities."
Service to Handicapped	"...most of...volunteer drivers have requested reassignment to other services closer to home." "...driver/escorts are now available only for real emergencies."
Private Health Agency	"Almost impossible to recruit new drivers at this time of shortage."
HELP Group	"We have lost 6 drivers recently, 3 also due to rising gasoline prices."
Nursing Home	"Have had to cancel programs because of shortage of supply and/or cost.
Private Literacy Program	"Volunteers used to pick up clients to take them to class. We have had to drop this service."

TYPE OF AGENCY	COMMENTS
Government Office	"We have lost 3 volunteers and 5 potential interns because of gas shortage."
County Department	"Energy crisis has been detrimental in recruitment." "High cost of gas definitely detrimental to volunteer retention."
U. Of Maryland Agency	"Have noticed a dramatic decrease in willingness of volunteers to make trips to provide services."

CONCLUSIONS:

Volunteer driver recruitment and retention is increasingly difficult. Cited reasons are increasing costs and the availability of fuel. The latter appears to be more pressing than the former.

The County agency volunteers may have to rely on use of County cars to carry out their assignments. Some agencies such as the Community Crisis Center and the Detention Center now use County cars almost exclusively. Increased usage by volunteers will have an impact on availability of County cars for all who need them. No study of the use of County cars by volunteers has been made.

A large majority of agencies in the public and private sectors favor increasing volunteer mileage deductions from the current rate to the same deduction that is allowed for business. Several indicated support for such legislation.

Chairman **Stark**. Thank you very much, Miss Crawford.

Mr. Guarini.

Mr. **Guarini**. I have no questions.

Chairman **Stark**. I appreciate your taking the time and the American Legion taking their time on behalf of the countless number of Americans who do contribute their time and effort, and resources to help those less fortunate than themselves. I assure you that this committee will do what we can to make their contributions more equitable and less of a penalty on them.

Mr. **Miller**. Mr. Chairman, if I may. I forgot to include—I have a copy of a letter that was sent to you from the Paralyzed Veterans of America. They have not only endorsed——

Chairman **Stark**. Without objection, Mr. Miller, we will make that part of the record.

Mr. **Miller**. Thank you very much, sir.

Chairman **Stark**. The next witnesses will be Mr. Carl Keller, director of taxes and Mr. John P. Cureton, vice president for industrial relations of the U.S. Tobacco Co.

Congressman Campbell had intended to be here as part of this panel. Mr. Guarini.

Mr. **Guarini**. Yes, I have a statement here by him which he had asked me to make part of the record.

Chairman **Stark**. Without objection, Congressman Campbell's statement will be made part of the record.

Do you have joint testimony, Mr. Keller and Mr. Cureton?

Mr. **Keller**. Yes.

Mr. **Cureton**. Yes.

Chairman **Stark**. You may proceed in whichever order or fashion you desire. Your prepared statements will be made part of the record.

I would ask you because these microphones are impossible to pick up any sound unless you practically swallow them, if you will get nice and close, the clerk will be able to get your testimony recorded. Thank you.

STATEMENT OF CARL KELLER, DIRECTOR OF TAXES, U.S. TOBACCO CO., GREENWICH, CT

Mr. **Keller**. Thank you.

My name is Carl Keller. I am director of taxes for United States Tobacco Co.

Congress has long encouraged the basic principle of furthering employee ownership of their company's stock by enacting and expanding such provisions as ESOPS—employee stock ownership plans.

In addition, Congress has encouraged companies to grant nonqualified options by granting a tax deduction to the company when the employee exercised the option to purchase the stock. So, we are most appreciative of the opportunity to speak today in support of H.R. 4114, the Employee Stock Ownership Assistance Act.

U.S. Tobacco Co. has been and continues to be committed to the reality of widespread employee ownership of our company's stock. Nonqualified stock options are an excellent vehicle for such employee stock ownership.

In our case, approximately 500 of our 3,000 employees hold nonqualified options. I would like to point out that there are only 28 officers of United States Tobacco Co. So, our plan is decidedly not a plan that was designed to reward only highly compensated executives.

Some time ago, we became quite concerned about the fact that despite significant appreciation in the market price of U.S. Tobacco stock, a great many of our nonqualified options were going unexercised. In an effort to determine why the options were in effect being left on the shelf, we interviewed a great many of our employees. The answer we received was crystal clear, the problem is the current law.

The current law requires payment of the tax at the time the option is exercised. In other words, before the employee has received any cash whatsoever from the sale of the stock. Thus, even with interest-bearing loans such as U.S. Tobacco provides to our employees for the purpose of assisting in the exercise of these options, a significant volume of nonqualified options are still going unexercised.

There are really only two alternatives: Either the employee can sell a portion of the stock which therefore defeats the purpose of having the option plan, or Congress can enact H.R. 4114.

The change in the Tax Code proposed in H.R. 4114 is very simple. The tax, now collected at the time a nonqualified stock option is exercised, would simply be deferred until the employee, at a time of his or her choosing, disposes of the stock. This tax treatment would be fair and equitable by matching the time for the payment of the tax with the receipt of cash from the sale of the stock. This would remove the cash impediment to exercise nonqualified stock options and will fulfill the basic purpose of having granted those options, increasing employee stock ownership.

When the stock is disposed of, the provisions of H.R. 4114 require that the amount of ordinary income deferred at the date of exercise now be recognized. In other words, a simple deferment of the original tax treatment. Any appreciation or depreciation in the value of the stock from the date of exercise will be treated as a disposal of a capital asset.

The company, which presently receives a tax deduction when the employee exercises the stock, would receive that same tax deduction. It would only be delayed now until the employee has sold the stock, thus simply change the timing of the same tax treatment. We believe the bill is revenue neutral.

With the company deduction also deferred along with the employee's tax until sale, the change in the Tax Code contained in H.R. 4114 should have no revenue loss. In fact, it is our view that earlier exercise of nonqualified options would result in a revenue gain because of the earlier receipt of dividends which would be taxable to our employee shareholders

Thank you very much for this opportunity to present our views.

[The prepared statement follows:]

STATEMENT OF CARL KELLER, DIRECTOR OF TAXES, U.S. TOBACCO CO., GREENWICH, CT

Mr. Chairman and members of the committee: My name is Carl Keller. I am Director of Taxes for U.S. Tobacco Company. U.S. Tobacco is most appreciative of the opportunity to testify in support of H.R. 4114, the Employee Stock Ownership Act.

U.S. Tobacco Company has been and continues to be committed to the reality of widespread employee ownership of our company's stock. Non-qualified stock options are an excellent vehicle for such employee stock ownership. As you are aware, a company granting non-qualified options is allowed a tax deduction equal to the amount of income recognized by the employee at the time an option is exercised. This deduction makes it financially feasible for a company to have a broadbased, non-qualified stock option plan. In our case, approximately 500 of our 3,000 employees hold non-qualified options. It should be noted that there are twenty-eight (28) officers of U.S. Tobacco Company. Our plan is decidedly not a plan conceived to reward only highly compensated officers of the company.

The management of U.S. Tobacco Company strongly believes that widespread employee ownership has several important benefits, both for the company and for the total economy. At a minimum, stock ownership by an employee tends to reduce the costly turnover so characteristic of a highly mobile society. Our own record is proof enough of this fact. In addition, by having employees possess a stake in the future of their corporation, we believe an increase in productivity will occur. Ownership through stock gives an individual employee a widened concern about the budget, the profitability, and the growth of his or her company.

Some time ago, we became concerned about the fact that, despite significant appreciation in the market price of U.S. Tobacco's stock, a large number of non-qualified options were going unexercised. In an effort to determine why the options were, in effect, being left on the shelf, we interviewed many of our option holders. The answers we received were crystal clear, both from those employees who fell within the highly compensated category, as well as those who did not. The reason? Current law which requires payment of tax at the time of exercising such options.

Under present law, the taxation of non-qualified stock options granted by a company to an employee is governed by Section 83. When the stock option is exercised, the difference between the value of the stock at the exercise date and the option price constitutes ordinary income to the employee. A tax is collected (a minimum of 20% of the spread) at the time of the exercise. As a result, the employee is placed in the very difficult position of having to pay income tax at a time when there has been no receipt of cash, since he/she has received only securities.

Thus, with interest bearing loans, such as U.S. Tobacco grants to its employees for the purpose of assisting in the exercise of stock options, a significant volume of non-qualified options are going unexercised. There are really only two alternatives: either the employee can sell a portion of his/her company's stock to raise the cash necessary to pay the tax, thereby defeating the very purpose for which the options were granted; or, H.R. 4114 can be enacted by Congress.

The change in the tax code proposed in H.R. 4114 is very simple. The tax now collected at the time a non-qualified stock option is executed would be deferred until the employee (at a time of his/her choosing) disposes of the stock. This tax treatment would be fair and equitable by matching the time for the payment of the tax with the receipt of cash at the time of the sale of the stock. This would remove the cash impediment to exercise non-qualified stock options and fulfill the basic purpose of granting options.

When the stock is disposed of, the provisions of H.R. 4114 require that the amount of ordinary income deferred at the date of exercise be recognized. Any appreciation or depreciation in the value of the stock from the date of exercise will be treated as a disposal of a capital asset. The company, which presently receives a tax deduction when an employee exercises an option, would instead receive that deduction when the stock is sold or otherwise transferred.

With the company deduction also deferred, along with the employee's tax, until transfer, the change in the tax code contained in H.R. 4114 would have no revenue loss. In fact, it is our view that earlier exercise of non-qualified options results in a revenue gain because of the earlier receipt of dividends which would be taxable to the employee-shareholder.

Congress has, in the past, encouraged the basic principle of furthering employee stock ownership by enacting such provisions as Employee Stock Ownership Plans (ESOPs, TRASOPs, PAYSOPs), Employee Stock Purchase Plans and the recently enacted incentive stock option plans which, it should be noted, grants not only deferral, but capital gains tax treatment to ISOs. Precedent exists in present law for deferring recognition of income in many transactions until cash is received. It is also true of Section 453 relating to the Installment Sales, which in a qualifying sale of real or personal property, generally defers income recognition until cash is received. It is also true of Section 1034 relating to the sale of a principle residence.

Mr. Guarini, Mr. Frenzel, and Mr. Campbell, the original sponsors of H.R. 4114 and other co-sponsors from the Committee, to include Mr. Duncan and Mr. Vander-Jagt of this Subcommittee, are to be commended for their initiative in this matter.

The Senate Finance Committee approved a provision modeled after S. 2162, the companion bill to H.R. 4114. In approving this change in current law, several restrictions were also approved. While we believe these restrictions are unnecessary, they should prevent any possible kind of abuse, however isolated.

It is our hope that this Committee will approve H.R. 4114. It is additionally our hope that, since this Committee has had an opportunity to review this legislation today, the House conferees, in a possible tax conference this year, will accept the Senate provisions which mirror H.R. 4114.

Thank you.

Chairman STARK. Thank you, Mr. Keller.

Mr. Cureton, do you have a statement?

STATEMENT OF JOHN P. CURETON, VICE PRESIDENT FOR INDUSTRIAL RELATIONS, TOBACCO DIVISION, U.S. TOBACCO CO., GREENWICH, CT

Mr. CURETON. Yes, Mr. Chairman, members of the committee, my name is John Cureton and I am vice president of personnel and industrial relations for U.S. Tobacco. I am also appreciative of the opportunity to testify today in support of H.R. 4114, the Employee Stock Ownership Assistance Act.

Our company, as you have heard, has over the years made extensive efforts to involve employees in and make them fuller participants in ownership of the company. We feel that when employees have a sense of ownership and a sense of belonging, they are more productive, motivated, stimulated to perform efficiently and effectively. It is very simple, when you own something, you take care of it. You protect it, and you put your best time and energies in to make it the best possible.

However, when you are offered something such as a nonqualified stock option and you understand it to have a certain worth but find there is an additional cost in order to possess it, it takes away from your motivation and interest in obtaining it.

What you have here with nonqualified stock options is an immediate taxation that has to be paid in cash as opposed to other plans which provide taxation at the point of disbursement. When the stock is sold, the amount of ordinary income deferred, and the date exercised will be recognized and the full tax paid.

Additionally, appreciation or depreciation would be treated as a gain or loss for the sale of the capital asset. The employer's tax deduction which now occurs when the employee exercises the option, would also be deferred until the stock is sold. Thus, the bill is revenue neutral.

Stock ownership as an incentive is going unused with a great number of employees because they do not have the ready cash and the financial means to pay the required up-front taxes for nonqualified stock options.

I am probably a typical example of employees who are excited about involvement and ownership in their company and striving to ensure its growth, but struggling to provide for kids' education and pay mortgages. I would accept my company's incentive if I did not have to pay such taxes up front and at the end of the year have my W-2 reflect the income which I have not realized.

This has a negative impact on the employees and can be changed very simply by eliminating the up-front tax requirement. About 500 of our employees presently have these nonqualified stock options and they cannot affort to exercise. They have made it clear that they cannot afford to exercise because of the up-front tax requirement.

My position affords me the opportunity, fortunately or unfortunately, to hear employees express their disenchantment with being offered an opportunity which they cannot afford.

Congress has in many ways attempted to encourage employers to use employee stock ownership as an incentive and there presently exists in other areas of the law the deferring of recognition of income until cash is received. Why not in this instance?

The present state of our economy demonstrates the need for Government and employers to use all the tools possible to continue to make our economy strong and our people stronger participants in the continued growth of our Nation.

Thank you.

Chairman STARK. Thank you very much.

Mr. Guarini, you are a cosponsor of this legislation. Indeed, you may be the sponsor of the legislation.

Mr. GUARINI. Yes.

Chairman STARK. Would you like to inquire or comment on it?

Mr. GUARINI. I think there are a few things, Mr. Chairman, we might have placed on the record.

Would either of you gentlemen review the provisions that were added to H.R. 4114 in the Senate bill?

Mr. KELLER. Yes, we have, Congressman.

Mr. GUARINI. Would you just quickly review them?

Mr. KELLER. The Senate has added several restrictions. First is the $100,000 cap, similar to the ISO's cap on the options that could be deferred from taxation each year. They entered the serial exercise rule which is similar to the ISO program. They have added a top-heavy rule which disallows plans that have awarded over 60 percent of the options to officers. They have added the fact that income deferred under H.R. 4114 would be subject to the alternative minimum tax situation.

All of these things are not so onerous that they could not be accepted.

Mr. GUARINI. Right. And those are acceptable, agreed upon items?

Mr. KELLER. Yes, the restrictions in the Senate version are quite acceptable.

Mr. GUARINI. And who did you discuss these changes with, Treasury, the Joint Tax Committee; were they participants in the discussions?

Mr. KELLER. I cannot answer that.

Mr. GUARINI. I understand that they had participated in the restrictions that were placed.

Mr. KELLER. That was our impression—I am sorry. They had agreed, the Senate. And then this morning we received an entirely different impression from Mr. Woodward in his remarks.

Mr. GUARINI. Right.

Well, now, there is a question of my bill being revenue neutral. I understand that first there was a fiscal note on it to the extent that it would be a $5 million benefit to the Government. Then there is some question, now, about it being a few million dollars' cost to the Government.

Could you explain that?

Mr. KELLER. Well, I cannot exactly explain where the numbers came from, of course. But I could comment, we do have the same tax treatment exactly, we have just delayed it. Plus, we are going to have earlier taxation of dividends.

So, we would think we would have, at the bare minimum, neutral and slightly positive.

Mr. GUARINI. So, in fact it is a matter of taking the dividends into account that makes the difference. But, however you look at it, there are a few million dollars one way or the other. So, essentially, the bill is revenue neutral; is that correct?

Mr. KELLER. Yes, sir; that is correct.

Mr. GUARINI. Thank you. No further questions.

Chairman STARK. As usual, we have left the best for last, and I thank the panel for their participation in our hearings today.

That concludes the hearings and the committee will stand adjourned, subject to the call of the Chair.

[Whereupon, at 2:25 p.m., the hearing was adjourned.]

APPENDIX

The text, description, and written comments received on bills which are the subject of this hearing follow. The bills are arranged in numerical order.

98TH CONGRESS
1ST SESSION

H.R. 676

To amend the Internal Revenue Code of 1954 to provide that certain indebtedness incurred by educational organizations in acquiring or improving real property shall not be treated as acquisition indebtedness for purposes of the tax on unrelated business taxable income.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 6, 1983

Mr. SHANNON (for himself, Mr. MARTIN of North Carolina, and Mr. GEPHARDT) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to provide that certain indebtedness incurred by educational organizations in acquiring or improving real property shall not be treated as acquisition indebtedness for purposes of the tax on unrelated business taxable income.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (9) of section 514(c) of the Internal Revenue Code of 1954 (relating to unrelated debt-financed income) is amended to read as follows:

"(9) REAL PROPERTY ACQUIRED BY A QUALIFIED TRUST OR EDUCATIONAL ORGANIZATION.—For purposes of this section—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'acquisition indebtedness' does not include indebtedness incurred by a qualified organization in acquiring or improving any real property.

"(B) EXCEPTIONS.—The provisions of subparagraph (A) shall not apply in any case in which—

"(i) the acquisition price is not a fixed amount determined as of the date of acquisition;

"(ii) the amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payment of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived from such real property;

"(iii) the real property is at any time after the acquisition leased by the qualified organization to the person selling such property to such organization or to any person who bears a relationship described in section 267(b) to such person;

"(iv) the real property is acquired by a qualified trust from, or is at any time after the acquisition leased by such trust to, any person who—

"(I) bears a relationship which is described in section 4975(e)(2) (C), (E), or (G) to any plan with respect to which such trust was formed, or

"(II) bears a relationship which is described in section 4975(e)(2) (F) or (H) to any person described in subclause (I); or

"(v) any person described in clause (iii) or (iv) provides the qualified organization with nonrecourse financing in connection with such transaction and such debt—

"(I) is subordinate to any other indebtedness or such property; or

"(II) bears interest at a rate which is significantly less than the rate available from any person not described in clause (iii) or (iv) at the time such indebtedness is incurred.

"(C) QUALIFIED ORGANIZATION.—The term 'qualified organization' means an organization described in section 170(b)(1)(A)(ii) and its affiliated support organizations described in Section 509(a) or a qualified trust.

"(D) QUALIFIED TRUST.—For purposes of this paragraph, the term 'qualified trust' means any trust which constitutes a qualified trust under section 401."

(b) The amendments made by this section shall apply to taxable years beginning after December 31, 1982.

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DESCRIPTION OF H.R. 676

Present Law.—Under present law, any qualified pension trust or organization that is otherwise exempt from Federal income tax generally is taxed on income from trades or businesses that are unrelated to the organization's exempt purposes (Code sec. 511.) Specific exclusions are provided for certain types of income, including rents, royalties, dividends, and interest.

Present law (sec. 514(a)) provides that an exempt organization's income from "debt-financed property" generally is subject to tax as unrelated business income in the proportion in which the property is financed by debt. Debt-financed property is defined as any property held to produce income with respect to which there is acquisition indebtedness at any time during the taxable year, or during the 12 months prior to disposition if the property is disposed of during the taxable year (sec. 514(b)). A debt constitutes acquisition indebtedness if the debt was incurred in acquiring or improving the property, or if the debt would not have been incurred but for the acquisition or improvement of the property (sec. 514(c)).

Present law provides an exception to the rule requiring taxation of debt-financed property. Under this exception, indebtedness incurred by a qualified pension trust as a result of the acquisition or improvement of real property is not considered "acquisition indebtedness" (sec. 514(c)(9)). Thus income or gain received from, or with respect to, such debt-financed property is not treated as income from debt-financed property. However, this exception does not apply if any of the following conditions are not met: (1) if the acquisition price is not a fixed amount determined as of the date of acquisition; (2) if the amount of the indebtedness, or the amount payable thereon, or the time for making any payments is dependent (in whole or in part) upon revenues derived from the property; (3) if the property is leased by the qualified pension trust to the seller or a person related to the seller; (4) if the property is acquired by the qualified trust from a person related to the plan under which the trust is formed or if such property is leased to such a related person; and (5) if the seller, a person related to the seller, or a person related to the plan provides nonrecourse financing for the transaction, and the debt is subordinate to any other indebtedness on the property or the debt bears a less than arm's-length interest rate.

Explanation of the Bill.—Under the bill, the present law exception to the debt-financed property rules for real property of a qualified pension trust would be extended to certain educational institutions (and certain affiliated support organizations). Eligible educational institutions are those institutions which normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where their educational activities are regularly carried on.

Effective Date.—The bill would be effective for taxable years beginning after December 31, 1982.

Revenue Effect.—The bill would reduce fiscal year budget receipts by $27 million in 1984, $50 million in 1985, $62 million in 1986, $78 million in 1987, $97 million in 1988, and $121 million in 1989.

Other Congressional Action.—The Senate Finance Committee adopted, as part of its deficit reduction provisions approved on March 21, 1984, a similar provision, but required that (1) in the case of a partnership, all partners be eligible institutions and (2) no ~~part of the~~ property be financed by the seller.

STATEMENT OF HON. JAMES M. SHANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

I appreciate this opportunity to talk about my bill, H.R. 676, and why I feel it is important that we provide this measure of tax relief to our educational institutions. As you know, one of my major interests since coming to Congress has been in using the tax code to support and assist higher education.

I guess it's pretty common knowledge that educational institutions these days are in a real financial squeeze. Inflation has relentlessly driven up the cost of everything it takes to keep a school going, from personnel, to the fuel used to heat the classrooms, to the food served in the cafeterias. Tuitions have risen, too—the cost of a private college education has risen by 107% over the past decade, that of a public college education by 92%—but not enough to bridge the gap.

There are basically three ways that a school can try to cope with this situation. It can raise tuitions still further—but at the risk of pricing itself out of the market, especially since the federal student aid programs that help students meet tuition costs have been cut back. It can look to the state or federal government for assistance—but federal education programs have been cut under the Reagan Administration, and most state budgets are already stretched to the limit. Besides, many schools, especially private ones, want to avoid too much dependence on government support. That leaves the third alternative—to increase the school's income from other sources.

One such source is investment income from the school's endowment. And this is a source which may not be meeting its full potential. A few decades ago, endowment income represented a respectable share of schools' current revenues. However, the share dropped from 18% to 8% during the 1940's, fell gradually to less than 5% in the early 1970's, and has remained at about that level ever since.

One factor that may be hindering the growth of income from these endowments is the restrictions imposed by the unrelated business income section of the tax code, and in particular section 514(c), which imposes a UBI tax on earnings from debt-financed real property which is not related to the institution's tax exempt purpose. This tax has the effect of discouraging investment in real estate—either the acquisition of property or the improvement of property already owned—most of which is, out of necessity, done through leveraging, both because it lowers the institution's rate of return and because it makes it more difficult for the institution to compete in the market with other investors.

As a result, there has been a tendency to concentrate endowment investment in stocks and bonds. But these have not proven to be a satisfactory vehicle for the kind of sustained growth that schools would like to see in their endowments. Such investments have tended to be risky, especially in the fluctuating economy of the past few years, and have produced a lower rate of return for investors than have real estate investments. A truly balanced investment portfolio should include the long-term stability provided by real estate investment.

A few years ago we granted an exemption from the general rule of 514(c) for tax-exempt pension trusts, recognizing that allowing them to accumulate funds in this matter served to facilitate their tax-exempt purpose of paying benefits to employees. The exemption for these trusts was accompanied by several limitations to prevent the kind of abusive transactions that had led to the enactment of this tax as part of the Tax Reform Act of 1969.

Allowing educational institutions to make this same sort of investment without incurring a tax penalty would similarly recognize the value of the resulting income in funding the educational activities for which these schools have been granted a tax exemption. H.R. 676 would do this by simply extending the exemption granted to pension trusts by 514(c)(9), including the safeguards against abuse, to educational institutions.

The revenue effect of this measure should not be great, as it would merely result in shifting funds to real estate from investments whose income is already tax-exempt. Furthermore, the total assets held by educational endowments are only about a twentieth the total for pension trusts; and the income from these endowments will reach a point where it is taxable much sooner than that of pension trusts. Endowment income is usually used for current expenses, and thus will be taxed as it reaches employees in the form of salary or businesses in the form of payment for goods and services. The income of pension trusts, on the other hand, may accumulate for years, until it is paid out upon the recipient's retirement.

As you know, an amended version of this proposal has been included in the Finance Committee's tax bill. As I understand it, some further restrictions on both educational organizations and pension trusts were added in order to make the provision acceptable to Treasury. The educational community tells me that it is willing to accept these limitations in exchange for the exemption from the unrelated business income tax; however, I am somewhat concerned that the pension trusts had the new restrictions sprung on them with no warning. If the exemption for educational institutions is retained in the final tax bill, and I certainly hope that it will be, I hope that at the very least we will provide the pension trusts with a generous transition rule so that those who were caught unawares will not suffer unduly through cancellation of deals already in the works.

This measure is one way that we can help our educational institutions to help themselves, without its costing the federal government an excessive amount of money. I urge the Subcommittee to approve an exemption from 514(c) for educational institutions, and urge the members of the conference committee to accept it as part of this year's tax bill.

Mayer, Brown & Platt,
Washington, DC, April 26, 1984.

Hon. Fortney H. Stark,
Chairman, Subcommittee on Select Revenue Measures,
Committee on Ways and Means, Longworth House Office Building, Washington DC.

Dear Mr. Chairman: This statement is submitted for the record of your April 12, 1984, hearing on H.R. 676, introduced by Mr. Shannon and others. Among other things, the bill would provide that certain indebtedness incurred by educational organizations and certain affiliated support organizations to acquire real property shall not be treated as acquisition indebtedness for purposes of the tax on the unrelated business income of tax-exempt organizations.

We support the bill as introduced. However, in response to the question raised at the hearing, we and our clients would strongly object to the addition of any provision which would make the present exception from the acquisition indebtedness provisions unavailable to a qualified section 401(a) trust ("qualified retirement trust") which invests in debt-financed real property by becoming a member of a partnership that includes one or more non-qualified persons as a partner. As you know, such a partnership "poison rule" is included in section 865 of the Deficit Reduction Act of 1984 recently approved by the Senate as an amendment to H.R. 2163.[1]

In summary, we believe that the partnership "poison rule" should not apply to any tax-exempt investor and particularly not to qualified retirement trusts. Alternatively, (1) a "poison rule" should apply only where there are abusive, disproportionate allocations of partnership income, expenses, credits, or basis (as measured initially by the provisions in the pending House and Senate bills applicable to certain deductions and credits otherwise available to partnerships which include tax-exempt entities [2]), (2) a de minimis rule and other appropriate protection should be provided for qualified retirement trusts and other tax-exempt investors investing in partnerships where there are disproportionate allocations which are not abusive, such a partnership where differential allocations are exclusively a function of the tax-exempt investors' senior equity position vis-a-vis other partners or where tax-exempt investors participate on the same tax and economic basis as do taxable limited partner investors in a widely held and publicly offered real estate partnership, and (3) appropriate transitional rules would be required for existing partnerships. Finally, the definition of a "qualified organization" should be expanded to include individual retirement accounts (IRAs).

PRESENT LAW RECOGNIZES THAT PENSION PLANS CUSTOMARILY INVEST IN REAL PROPERTY WITH TAXABLE PARTNERS

Since 1980, qualified retirement trusts have been exempted under Code section 514(c)(9) from any unrelated business income tax arising from debt-financed real property. This treatment was granted because the income from qualified retirement trusts ultimately is taxed in the hands of their beneficiaries. S. Rep. No. 1036, 96th Cong., 2d Sess. 29 (1980). Moreover, it was clearly contemplated that qualified retirement trusts would invest through joint ventures and partnerships. Id. at 31. Nevertheless, the current Finance Committee explanation gives no reason for adopting its pending "poison rule". See Finance Committee Print, vol. I at 849.

THE "POISON RULE" DISCOURAGES PENSION PLAN INVESTMENTS IN REAL PROPERTY AND IS UNFAIR TO SMALLER TRUSTS

Our clients include major advisors or sponsors for investment in real property by retirement trusts and other tax-exempt investors. Many current real estate limited partnerships being publicly offered permit both qualified retirement trusts and others to invest as limited partners on equal terms. Investing in these partnerships is important to qualified retirement trusts which are too small to purchase real property directly or which seek to diversify their real property investments (as required by ERISA) through partnerships and desire to use leverage in connection with their investments. (The same benefits would, we believe, accrue to educational organizations under H.R. 676 as introduced.)

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[1] Section 865(a), adding subparagraph (B)(vii) to Code section 514(c)(9). S. Prt. 169, 98th Cong., 2d Sess. (the "Finance Committee Print"), vol. II at 1113 (1984).

[2] *See* H.R. 4170, section 32(a), inserting new subsection (j)(8) to Code section 168, H. Rep. 432, 98th Cong., second session, pt. 2 at 36–38 (1984); and Senate amendment to H.R. 2163, section 22(a), Finance Committee Print, vol. II at 34–36.

Even large qualified retirement trusts could face difficulties making leveraged real property investments directly in order to avoid any "poison rule". Many such investments are structured as partnerships between taxable and tax-exempt investors in which the qualified retirement trust or other tax-exempt financial partner provides the capital and the taxable party the real estate expertise. Furthermore, large trusts would in most cases prefer to invest smaller amounts through several partnerships in order to continue to diversify their investments and to obtain the expertise of more experienced partners.

A partnership "poison rule" would unfairly discriminate against smaller tax-exempt organizations that, because of their limited resources, must rely on joint investments in real property through the partnership vehicle. The tax-exempt organizations frequently enjoy a senior equity position as financial partners, and another partner is typically a taxable corporation with expertise in real property acquisition, development, and management. It is unlikely that qualified retirement trusts or other tax-exempt organizations would be found which would be able and willing to shoulder these responsibilities and to act as general partners. Moreover, qualified retirements trusts and other tax-exempt organizations of all sizes find joint venture investment with knowledgeable and experienced taxable partners a cost effective and efficient way to achieve meaningful diversification.

ANY "POISON RULE" SHOULD BE SUBJECT TO A DE MINIMIS EXCEPTION AND APPLY ONLY IF THERE ARE DISQUALIFIED ALLOCATIONS

A "poison rule" might be viewed as a response to the concern that the benefits of tax-exempt status should not be shared with taxable parties by use of partnership allocations. If so, the application of the rule should be carefully limited to apply only where there are abusive, disproportionate allocations of income, expense, credits, or basis between tax-exempt and taxable partners. That is, the "poison rule" should not apply if there is a "qualified allocation" as measured by section 32 of H.R. 4170 and section 22 of the Senate bill, which address initially the same concerns in the context of leases of property by partnerships which include both tax-exempt and taxable partners.

In addition, three exceptions to the "poison rule" should apply: (1) where the only differential partnership allocations result from the senior equity position of the tax-exempt investor, (2) where the tax-exempt investor in a widely held and publicly offered limited partnership invests on the same terms as taxable investors, and (3) where the percentages of partnership debt, distributions, profit, loss, capital, etc. held by all qualified retirement trusts are less than 25% of the aggregate partnership interests. For example, it is not uncommon for the taxable partner which is a developer or manager to receive a preferential share of cash from operations as compensation for operating the real property investment but to give the qualified retirement trusts or other limited partners who provide capital preferences on sale. Such preferences recognize the economics of the transaction and are motivated by tax considerations.

We would also suggest that, as in section 32 of H.R. 4170 and in section 22 of the Senate bill, the "poison", in the event the provision applies, should be based on the tax-exempt investor's proportional ownership of the real property. Otherwise, the same allocations could produce a greater penalty, proportionately, for the tax-exempt investor than for the taxable investor—a result which would be both anomalous and unfair.

TRANSITIONAL TREATMENT

The most recent Stanger Register suggests that more than 40 real estate limited partnerships being publicly offered are committed to use leverage in investing in debt-financed real property and may sell interests to qualified retirement trusts. If, notwithstanding the foregoing arguments, a "poison rule" is adopted, an exception must be provided for qualified retirement trusts which have invested in public limited partnerships that are committed to use debt-financing to acquire real property.

We, thus, suggest that any "poison rule" not apply to debt incurred by a partnership if (1) before October 21, 1983, the partnership was organized and publicly announced the maximum amount of interests which would be sold in the partnership and (2) the marketing of partnership interests is completed not later than 90 days after the date of enactment and the aggregate interests sold in the partnership do not exceed the maximum amount announced. This is the same exception from the tax-exempt entity leasing rules provided in the Senate amendment. *See* Finance Committee Print, section 22(g)(11)(B), vol. II at page 57.

THE DEBT-FINANCED PROPERTY EXCEPTION SHOULD BE EXPANDED TO INCLUDE IRAS

Finally, we urge that the definition of "qualified organization" which would be added by H.R. 676 and the Senate bill [3] be expanded to include individual retirement accounts (IRAs). IRAs have the same attributes, for purposes of the debt-financed property rule, as retirement plans; they accumulate funds on a tax-exempt basis for eventual distribution at retirement to individuals who will be taxed on such distributions. Some IRAs are funded by "rollover distributions" from qualified retirement plans. Because of their relatively small size, IRAs can be invested in real property only through a pooled investment vehicle such as a partnership. IRAs should be permitted the same investment plans by expanding section 514(c)(9)(C) to include IRAs as "qualified organizations".

We would, of course, welcome the opportunity to pursue this matter with you or your staff.

Respectfully,

JERRY L. OPPENHEIMER.

WEBSTER & SHEFFIELD,
New York, NY, April 26, 1984.

Re H.R. 676—Exemption from unrelated business income tax for debt-financed real property investments.

JOHN J. SALMON, Esq.,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, DC.

DEAR MR. SALMON: We represent several firms involved in providing real estate investment advice to qualified retirement plans.

On April 12, 1984, the Subcommittee on Select Revenue Measures held hearings on H.R. 676, a bill which would amend the debt-financed property rules of the Internal Revenue Code to allow educational institutions and certain of their affiliated support organizations to make leveraged real estate investments without incurring unrelated business taxable income. The Senate companion bill to H.R. 676 (S. 1183) was recently passed by the Senate as Section 865(a) of the Deficit Reduction Act of 1984. Section 865(a) would extend Section 514(c)(9) to certain educational institutions and title holding companies but would add substantial new restrictions on the availability of Section 514(c)(9).

In testimony before the Subcommittee on Select Revenue Measures, Robert G. Woodward, Tax Legislative Counsel, indicated that Treasury would support H.R. 676 only if the restrictions contained in the Deficit Reduction Act were incorporated. For the reasons outlined below we believe that the overly broad limitations contained in Section 865(a) would adversely affect the investment returns earned by pension trusts, unnecessarily restrict the common real estate investment practices of such trusts, and impair real estate capital markets.

We note that the language of Section 865 of the bill was worked out behind closed doors with the pension investment community having no opportunity to consider the additional restrictions proposed by Treasury—restrictions which will have extremely far-reaching adverse effects on the ability of pension trusts to engage in many beneficial and entirely non-abusive real estate transactions—prior to their adoption by the Senate Finance Committee. Furthermore, the Senate bill, and the changes proposed by Treasury, fail to provide reasonable transitional relief for many major transactions that were well under way when the Finance Committee adopted these broad new restrictions.

Section 865(a) would amend Code Section 514(c)(9) to: (i) effect a complete ban on partnerships with taxable and tax-exempt partners; (ii) effect a complete ban on seller financing; and (iii) fail to provide any transitional relief for transactions commenced prior to the Senate Finance Committee action.

The following proposed modifications to these provisions of the Senate bill would eliminate the potential abuses that the Treasury Department has identified and provide fair transitional relief.

1. Debt-Financed Income—Complete Ban on Partnerships with Taxable Partners

Problems.—Pension trusts frequently invest in real estate by forming partnerships with developers or other taxable investors in order to develop or operate various types of real property. While larger pension funds may be able to furnish all of the necessary captial for these projects, providing the developer with an equity interest in the venture encourages more efficient development work and is generally consistent with ERISA prudence and diversification requirements. Also, smaller pension funds are not usually in a position to provide all of the needed capital. Frequently, these partnerships will obtain construction or permanent financing for some portion of the cost of the project, particularly for very large projects. Under the bill, however, a pension trust would always be taxed on the "debt-financed portion" of its investment return from these partnerships regardless of whether the partnership agreement attempts to transfer the tax benefits attributable to the exempt partners to the taxable partners. This would be the case even though the enactment of the "tax-exempt leasing" provisions of both tax bills would already apply to the transfer of unused tax benefits by tax-exempt organizations to taxable parties. Moreover, pension trusts could be taxed on their debt-financed income even where they form partnerships with other entities that are not subject to tax (e.g., bank common trust funds or Section 501(c)(3) organizations). As a result of these provisions, pension trusts will be severely discouraged from entering into real estate projects with developers or owning real estate, thereby limiting the available supply of capital for such projects.

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[3] Proposed new subparagraph (C) to Code section 514(c)(9). H.R. 676, section (a) at page 4; Finance Committee Print, section 865(a), vol. II at 1113.

Proposal.—The major potential abuse that the Treasury Department has identified, i.e., the transfer of substantial unused tax benefits to taxable investors, would be effectively eliminated by the tax-exempt leasing provisions of both tax bills. Another perceived abuse, the possible incentive for taxpayers to make charitable donations of tax-shelter interests to educational organizations after the "cross over" point, could be closed off by taxing debt-financed investments in partnerships with taxable partners where the educational organization receives its interest as a contribution of property for which a charitable deduction is allowable to the donor. This rule would supplement the substantial limitations on the potential transfer of tax benefits by tax-exempt partners that are already included in the tax bills, without precluding many beneficial and entirely nonabusive real estate projects. Alternatively, if such a provision were deemed necessary, pension trusts investing in partnerships with taxable entities could be subject to the tax on unrelated debt-financed income where any allocation in the partnership was not a "qualified allocation" as defined by proposed Section 168(j)(9) of the Senate Tax Bill.

2. Debt-Financed Income—Complete Ban on Seller Financing Problem.—Seller financing plays an important role in many real estate acquisitions by pension trusts. For example, a pension trust may be able to invest in a larger number of diverse properties—consistent with ERISA fiduciary rules—by negotiating to have the seller "take back" some part of the purchase price. In the case of very large properties or when credit is tight, sellers may not be able to liquidate their investment unless they provide some financing, at least on a short-term basis. Moreover, pension trusts sometimes are able to negotiate better (but still arms-length) financing terms with sellers than with banks, and opportunities regularly arise to assume prior existing debt of the seller at a very favorable interest rate. The Senate bill would tax all investments that involve seller financing.

Proposal.—Present law already prevents taxable sellers from converting interest income into capital gain through the provision of nonrecourse financing at an interest rate that is significantly below market rates. Accordingly, this provision of the bill needlessly imposes additional restrictions on seller financing. At the very minimum, however, these restrictions should not apply to (1) short-term (i.e., 5 years or less) financing where there is an arms-length interest rate or (2) to an assumption of indebtedness between the seller and an unrelated party that was in existence at least one year prior to the acquisition by the tax-exempt organization.

3. Debt-Financed Income—No Transitional Relief Problem.—Numerous partnerships, designed to provide real estate investment opportunities to tax-exempt pension trusts, were organized prior to the date of Finance Committee action in this area (March 13). In many of these cases, it is intended that debt financing would be important to the economic viability of the partnerships. These partnerships had no reason to anticipate that such financing would generate taxable debt-financed income for the tax-exempt investors because no hearings were held, and no other notice of the proposals was available, prior to March 13.

The applicability of the proposed restrictions (even if modified somewhat as described above) to such partnerships would substantially disrupt reasonable investor expectations and could well destroy their economic viability in general. In this regard, while the tax-exempt leasing provisions of the bills are intended to provide transitional relief to some of these same partnerships, broader relief is appropriate in this area since the partnership restrictions were not announced or adopted until March 13, 1984.

Proposal.—The proposed additional restrictions under section 514(c)(9) should not apply to "acquisition indebtedness" incurred after the date of enactment by a partnership (including a partnership that is owned by a partnership which satisfies the requirements of this transitional rule) where (1) the partnership was organized before March 13, 1984, (2) the partnership agreement or offering documents, as in effect prior to March 13, 1984, clearly indicated that indebtedness would be incurred, and (3) such indebtedness is actually incurred on or before June 30, 1983.

For the reasons stated above, we urge the Committee to implement the changes outlined in this letter when the provisions of H.R. 676 and those of Section 865(a) of the Deficit Reduction Act are considered by the Committee on Conference. We share Treaury's concern that as a matter of sound tax policy the abuses that the Treasury amendments to Section 514(c)(9) are directed against must be prevented. We strongly believe, however, that it is unsound tax policy to severely restrict the breadth of investments that pension trusts are allowed to make when such necessary restrictions go substantially beyond those required to prevent the perceived abuses.

Respectfully submitted,

RICHARD K. DESCHERER.

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98TH CONGRESS
1ST SESSION

H. R. 2697

To amend the Internal Revenue Code of 1954 to provide that the standard mileage rate for use of a passenger automobile which may be used in computing the charitable contribution deduction shall be the same as the standard mileage rate which may be used in computing the business expense deduction.

IN THE HOUSE OF REPRESENTATIVES

APRIL 21, 1983

Ms. MIKULSKI introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to provide that the standard mileage rate for use of a passenger automobile which may be used in computing the charitable contribution deduction shall be the same as the standard mileage rate which may be used in computing the business expense deduction.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 170 of the Internal Revenue Code of 1954 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (h) and (i) as subsections (i) and (j), respectively, and by inserting after subsection (g) the following new subsection:

"(h) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—If the Secretary prescribes by regulation a standard mileage rate which may be used to compute for the taxable year the deduction under section 162 for use of a passenger automobile, such standard mileage rate may be used to compute for such year the deduction under this section for use of a passenger automobile."

(b) The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1983.

DESCRIPTION OF H.R. 2697

Present Law.—Unreimbursed out-of-pocket expenses incurred by a taxpayer incident to the rendition of services provided to a charitable organization, such as fuel costs for a vehicle, are treated as charitable contributions (Treas. Reg. sec. 1.170A-1(g)). In determining the amount of the contribution deduction attributable to the operation of a vehicle, the taxpayer may deduct actual expenses, or may use a standard rate. At present, the standard rate for charitable deduction purposes is nine cents a mile (Rev. Proc. 82-61, 1982-2 C.B. 849). Under either computation method, the taxpayer may also deduct parking fees and tolls, but may not deduct general repair or maintenance costs, depreciation, insurance, or other expenses.

Explanation of the Bill.—Under the bill, taxpayers would be allowed to determine the amount of their charitable contribution deduction for the use of a passenger automobile pursuant to the standard mileage rate applicable for that year in computing the business expense deduction for business use of a passenger automobile.

As most recently established, the standard mileage rate which may be used in computing the business expense deduction for business use of a passenger automobile (if the vehicle is not fully depreciated) is 20.5 cents a mile for the first 15,000 miles of business use during the taxable year, and 11 cents a mile for each additional mile (Rev Proc. 82-61, *supra*, as modified by Rev. Proc. 83-74, 1983-41 I.R.B. 16).

Effective Date.—The provisions of the bill would apply to taxable years beginning after 1983.

Revenue Effect.—The bill would reduce fiscal year budget receipts by $18 million in 1984, $120 million in 1985, $141 million in 1986, $166 million in 1987, $196 million in 1988, and $231 million in 1989.

Other Congressional Action.—The Senate Committee on Finance adopted, as part of its deficit reduction provisions approved on March 21, 1984, an increase to 12 cents per mile in the standard mileage rate for charitable deduction purposes, effective January 1, 1985.

STATEMENT OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons would like to express its support for H.R. 2697, legislation that would increase the standard mileage rate charitable deduction for a passenger automobile. At a time when social needs are increasing and federal funding to meet these needs is decreasing, citizen participation in charitable activities should be encouraged through all possible means, including tax policy.

Under present law, individuals are allowed only a nine cents per mile deduction for charitable uses of their automobile. This rate has increased by only five cents since its inception in 1958. Recent estimates place the cost of operating an automobile at nearly 24 cents per mile. In light of this cost, the present rate, which covers only a driver's gasoline and oil expenses, serves as a substantial disincentive to the use of automobiles for charitable purposes.

The present rate has a great impact upon those persons who volunteer their time to assist charitable organizations. These volunteers are essential to the well being and even survival of the nation's needy. The current low mileage deduction often forces volunteers to pay too great a price in order to contribute their services to such important efforts as feeding the elderly, helping the disabled and caring for the sick.

While an increase in the deduction for one's charitable use of an automobile would have an impact upon tax revenues, this loss must be compared not only to the total value of volunteer activities in this nation, but also with the savings to the government as a result of increased charitable activity. Also, this legislation must be recognized as merely requiring parity with the current automobile deduction allowed for government and business purposes.

This legislation both recognizes and encourages the enormous contribution of charitable organizations to this nation. Therefore, A.A.R.P. supports H.R. 2697 as a necessary measure to eliminate a major disincentive towards increased volunteerism.

STATEMENT OF THE AMERICAN HEART ASSOCIATION

The American Heart Association appreciates the opportunity to submit its written comments on H.R. 2697.

On behalf of the American Heart Association and its 2 million volunteers, we would like to speak in support of H.R. 2697 which amends the Internal Revenue Code to increase standard mileage deductions for volunteers to be equal with the standard mileage deducation for business. If passed, H.R. 2697 would raise the charitable mileage deduction for volunteers from 9¢ to 20 cents, thus giving volunteers the same tax break as businesses and government employees.

The Senate Finance Committee has already taken the first step in raising the tax deducation for volunteers by increasing the tax deduction from 9¢ to 12¢, but that does not go far enough. It is important that volunteers receive the same tax incentives as federal employees and businessmen if the United States is to maintain the quality volunteer system it has historically.

Volunteers are the backbone of our nation's charitable organizations.

In 1982, President Reagan asked Americans to fill the gap that would be created by billions of dollars in federal budget cuts in health, social and welfare programs. However, filling this gap has not been easy. Economic pressures threaten to force dedicated people out of the volunteer ranks at the very time those voluntary services are most vital to fill the need caused by cuts in domestic programs. One such economic problem for volunteers is the cost of gasoline and auto repairs.

The American Automobile Association (AAA) estimates that it costs an average of 30 cents per mile to own and operate a car, yet volunteers are only reimbursed 9¢ per mile—that is less than one-third the actual cost of running a car, and that is not fair or equitable.

Because volunteers provide the energy that enables private sector organizations to carry out manifold activities that are in the public interest, they are a national treasure, and they must be treated as such. They must be encouraged to volunteer by being rewarded through tax incentives. Studies indicate every dollar given to charitable organizations is multiplied 3 to 4 times through the efforts of volunteers, thus allowing the private sector to administer services the Federal Government would otherwise be responsible for providing.

If voluntary organizations are to undertake an increased burden as a result of the public demand for decreased federal spending, we need all the volunteer assistance we can get. The American Heart Association believes that one way to encourage people to volunteer is by implementing tax incentives such as increasing the mileage deduction to 20 cents per mile. This could be the added incentive needed to continue to fill the void that was created by domestic budget cuts in federal spending in 1983, 1984 and 1985.

The American Heart Association would like to take this opportunity to urge you to support H.R. 2697. Thank you.

STATEMENT OF THE AMERICAN HOSPITAL ASSOCIATION

The American Hospital Association, which represents more than 6,100 member hospitals and health care institutions, as well as 38,000 personal members, is pleased to have this opportunity to comment on H.R. 2697. This legislation would amend the Internal Revenue Code of 1954 by increasing the volunteer mileage deduction to the same level government employees receive for using their automobiles for business activities. The rate for business and government is 20 cents per mile, while the mileage deduction for volunteers is 9 cents per mile.

AHA strongly supports H.R. 2697, sponsored by Representative Barbara Mikulski. Hospitals rely heavily on the services of more than 5 million individuals who donate their time and energy in performing volunteer work. With growing concern over inflation and the federal budget, the burden of filling gaps in social programs has fallen upon volunteers. Although the government encourages charitable contributions, it does not support this policy with equitable tax laws.

IMPORTANCE OF VOLUNTEERS

Throughout the history of the United States, charitable contributions, both in financial assistance and manpower, have been vital to the health care system. Contributions have reflected and fostered a highly desirable participatory attitude by individuals towards the health needs of their communities. Direct contributions have enabled hospitals to replace obsolete facilities and equipment; conduct research and educational activities; maintain and improve community health care through subsidizing the costs of providing care to indigent patients; and finance the development of innovative approaches of delivering effective health services.

In addition, philanthropic support has complemented other sources of health care financing. Volunteer services humanize the hospital environment and provide hospitals with the personnel needed to maintain important patient care programs. Volunteers comfort familes in emergency, recovery, and intensive care waiting rooms and as patient visitors they frequently act as a liaison in bringing patients' problems or special needs to the attention of hospital personnel. They have allowed hospitals to expand patient education activities related to nutrition, exercise and natural childbirth. Gift shops and cafeterias are staffed by volunteers, and psychological support programs are maintained through their services.

Within communities, volunteers serve as the persuasive voice of hospitals. They have raised funds to combat cancer, heart disease, and birth defects.

They also deliver hot meals to the homes of the indigent and elderly citizens through the "Meals on Wheels" program. Volunteers participate in health promotion and disease prevention efforts by providing and distributing printed materials on nutrition, risks of smoking, and alcohol abuse. Furthermore, they have initiated outreach programs including health screening and referral services. Volunteers are the logical and effective source of assistance in meeting the present hospital and community needs.

BURDEN ON VOLUNTEERS

The American Automobile Association has estimated the total cost of driving a car to be more than 23 cents per mile and other estimates range as high as 50 cents per mile. But, the volunteer mileage deduction, which became law in 1958 at 7 cents per mile, currently remains at 9 cents in contrast to the deduction of 20 cents per mile for business and government use. If it costs 20 cents a mile for a businessman to operate a motor vehicle, it cost equally as much for a volunteer.

In 1958 gasoline cost 29 cents per gallon while oil was 15 cents per quart. Today, the cost of gas is more than $1 per gallon and oil exceeds $1 per quart. The present low rate of reimbursement in no way approximates the cost of fuel and maintenance required to operate an automobile. The severe increases of inflation have put constraints on all aspects of our society, including volunteers, and this burden threatens to curtail growth within the nation's pool of volunteer resources.

It is in the interest of both local and national efforts to address community needs through private initiative, and subsequently appropriate to encourage volunteer work through federal tax policy. The volunteer mileage deduction bill gives minimal compensation to volunteers who are seeking financial relief from the high cost of operating automobiles. The time to act is now, and tax incentives are the first step in recognizing the worth of those volunteers who give their time, energy, talent, and privately owned vehicles to provide a needed service for our society.

AHA appreciates the opportunity to express its support for H.R. 2697 and we will be pleased to provide any additional information that the committee may request.

AMERICAN RED CROSS,
Washington, DC, May 10, 1984.

Hon. FORTNEY H. STARK,
Chairman, Subcommittee on Select Revenue Measures,
Committee on Ways and Means, U.S. Congress, Washington, DC.

DEAR MR. CHAIRMAN: As National Chairman of Volunteers of the American Red Cross, I am writing to represent both myself as a volunteer and more than 1.4 million Red Cross volunteers who serve their fellow Americans in nearly 3,000 Red Cross chapters across the nation. More than half of these chapters are staffed entirely by volunteers.

On their behalf, I urge enactment of Congresswoman Mikulski's Bill, H.R. 2697, which would correct a gross inequity by permitting volunteers who use their personal automobiles in their charitable work to deduct from their Federal income taxes the same amount which business persons are allowed to deduct for the use of their automobiles on company business.

The present mileage allowance for the charitable use of a personal motor vehicle is 9¢ per mile while the use of a personal vehicle for business purposes is currently

20¢ per mile. Thus, a Red Cross volunteer who serves in a hospital comforting and aiding the patients is allowed to deduct only 9¢ per mile to drive there while a salesperson calling on that same hospital to make a sale of drugs, medical supplies or equipment is allowed to deduct 20¢ per mile. The salesperson has the satisfaction not only of making a profit from the sale, but he also has the benefit of receiving more than twice the mileage allowance granted to the volunteer.

Likewise, a Red Cross volunteer reporting to a Red Cross disaster shelter is allowed to deduct only 9¢ per mile to drive to that shelter to assist the victims of the disaster while an insurance adjuster, for example, is allowed to deduct 20¢ per mile to drive to the same disaster site.

Previous statements by the Treasury Department not withstanding, there is simply no rational argument to support this unfair differential. The costs of operating a motor vehicle are the same whether the owner/operator is a business person driving to and from a place of business to earn a profit, or a Red Cross volunteer driving to and from a hospital, a disaster site, or anywhere else to aid and comfort a fellow citizen in distress. Regardless of ownership, automobiles still burn gasoline, still must be covered by insurance, still depreciate from age and usage, and still must be maintained and repaired.

Therefore, the American Red Cross on behalf of its volunteers who give so much to so many, urges the Committee to approve H.R. 2697.

Respectively submitted,

JACKIE H. DAVID,
National Chairman of Volunteers.

JEWISH WAR VETERANS OF THE UNITED STATES OF AMERICA,
Washington, DC, April 6, 1984.

HON. FORTNEY H. (PETE) STARK,
Chairman, Subcommittee on Select Revenue Measures, Longworth House Office Building, Washington, DC.

DEAR CONGRESSMAN STARK: The Jewish War Veterans of the United States of America, America's oldest active veterans organization, would like to submit the following statement for inclusion in the Subcommittee record, for the hearing to be held on April 12, 1984, regarding the H.R. 2697, the Volunteer Mileage Deduction Bill.

Sincerely,

JOSEPH ZOLDAN,
National Commander.

Attachment.

Mr. Chairman and Members of the Subcommittee: The Jewish War Veterans of the United States of America strongly endorses H.R. 2697, commonly known as the Volunteer Mileage Deduction Bill.

This bill would raise the amount volunteers can deduct for driving their cars for charitable purposes. The business community can deduct 20.5 cents per mile at the present time; yet volunteers can only deduct 9 cents per mile. This disparity should be removed.

Since the members of our organizations are actively involved in volunteer activities it seems that this bill is the least our goverment can do for those willing to give their time and effort to help others. In this time of budget cuts and resulting service reductions, the call for volunteer assistance is greater than ever. Without the passage of this legislation, massive cutbacks in volunteer programs could occur, severely curtailing services basic to the functioning of our society. The passage of this H.R. 2697 would tell our country's volunteers that their efforts are appreciated and needed.

It is also important to remember that the real beneficiaries of passage of this bill will be those thousands who are helped by volunteers.

STATEMENT OF DONALD H. SCHWAB, DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES

Mr. Chairman and members of the subcommittee, thank you for the privilege of presenting to this distinguished Subcommittee the views of the Veterans of Foreign Wars of the United States.

My name is Donald H. Schwab and it is my privilege to serve the more than 1.97 million men and women of the Veterans of Foreign Wars as their National Legislative Director.

Mr. Chairman, of the several measures under consideration today, three would amend the Internal Revenue Code of 1954 to provide that the standard mileage rate for use of a passenger automobile which may be used in computing the charitable contribution deduction shall be the same as the standard mileage rate which may be used in computing the business expense deduction. Specifically, the bills are H.R. 358, introduced by the Honorable Robert A. Roe; H.R. 2697, introduced by the Honorable Barbara A. Mikulski; and H.R. 3212, introduced by the Honorable John Paul Hammerschmidt. As you are aware, Mr. Chairman, similar legislation has been introduced in consecutive Congresses for nearly a decade and has failed advancement.

The legislation in question would increse the tax deduction for volunteers from nine cents (9¢) per mile to 20 cents per mile and would go a long way towards increasing services rendered by volunteers. Incidentally, an Internal Revenue Service News Release, dated October 3, 1983, stated that the standard mileage rate for cars used in business in 1983 would be 20.5 cents a mile with no change in the nine cents (9¢) per mile tax deduction for volunteers.

Throughout the Veterans Administration Voluntary Service (VAVS), more than 78,000 volunteers provide over 12 million hours of service to hospitalized veterans. The membership of the Veterans of Foreign Wars and our Ladies Auxiliary comprises over ten percent (10%) of this total effort. This makes the Veterans Administration the model agency of organized volunteer services. It should be noted that the Veterans Administration's volunteer effort not only benefits older Americans who are hospitalized in Veterans Administration facilities but it also provides a meaningful and productive activity for senior citizens, including both veterans and non-veterans who served as volunteers themselves throughout various veteran's service organizations and other groups such as the Retired Senior Volunteer Program (RSVP). However, serious problems impacting adversely on volunteer programs throughout the Nation have been the high cost of gasoline coupled with the diminishment or non-existence of public transportation in many areas and the unrealistic nine cents (9¢) per mile limitation on the allowable income tax deduction.

Mr. Chairman, the dollar value of the services rendered gratuitously by volunteers cannot accurately be computed, but the loss or even reduction of their donated time could be devastating to all volunteer programs; and, therefore, the disincentive of the wholly unrealistic nine cents (9¢) per mile limitation on income tax deductions should and must be remedied.

Mr. Chairman, the Veterans of Foreign Wars of the United States strongly supports the early passage of the pending remedial legislation to enhance volunteerism which has been so publicly and openly espoused by the Administration.

Thank you, Mr. Chairman, and members of the Subcommittee.

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98TH CONGRESS
1ST SESSION

H. R. 4114

To amend the Internal Revenue Code of 1954 to defer the inclusion in income with respect to transfers of stock in a corporation pursuant to certain employee stock options.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 6, 1983

Mr. GUARINI (for himself, Mr. CAMPBELL, and Mr. FRENZEL) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to defer the inclusion in income with respect to transfers of stock in a corporation pursuant to certain employee stock options.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I

SECTION 101. SHORT TITLE.

This Act may be cited as the "Employee Stock Option Revision Act".

SEC. 102. AMENDMENT OF 1954 CODE.

Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE II

SEC. 201. PROPERTY TRANSFERRED IN CONNECTION WITH PERFORMANCE OF SERVICES.

(a) IN GENERAL.—Section 83 (relating to property transferred in connection with performance of services) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) CERTAIN TRANSFER OF STOCK.—

"(1) DEFERRAL OF INCOME INCLUSION.—

"(A) IN GENERAL.—In the case of a transfer of stock in a corporation pursuant to an employee stock option to an individual, such individual (if both the corporation and the individual elect) shall not include in gross income the amount determined under subsection (a) until such time as a disposition of such stock occurs.

"(B) ELECTION.—An election under paragraph (1) shall be made in such manner as the Secretary shall prescribe.

"(2) EMPLOYEE STOCK OPTION DEFINED.—For purposes of this subsection, the term 'employee stock option' means an option granted to an individual who at the time of the grant was an employee of either the corporation granting such option, a parent or subsidiary corporation of such corporation, or a corporation or a parent or subsidiary corporation of such corporation issuing or assuming such stock option, but only if—

"(A) the option is not for the purchase of statutory option stock as defined in section 425(c)(3)(B),

"(B) such option by its terms requires that stock certificates issued upon exercise be retained by the corporation or its agent for the benefit of the employee or requires the use of restrictive 'legends' or 'stop-transfer' instructions with respect to stock certificates, and

"(C) the corporation notifies the Secretary of the sale of option stock in such a manner as the Secretary prescribes.

For purposes of subparagraph (B), use of a stamp or print which appears on the face of the certificate or other instruments evidencing restrictions as to transfer which require employer notification as to a disposition shall constitute satisfaction of the requirements of this subsection.

"(3) DISPOSITION DEFINED.—For purposes of this subsection, the term 'disposition' has the meaning given such term in section 425(c)(1) (determined without regard to subparagraph (A) thereof)."

(b) EFFECTIVE DATE.—The amendments made by this Act shall apply to the transfer of stock pursuant to the exercise of stock options after the date of the enactment of this Act.

DESCRIPTION OF H.R. 4114

Present Law.—Under present law, the tax treatment of employee stock options generally is governed by section 83 and the regulations thereunder (Treas. Reg. S1.83-7). Under these rules, the value of a stock option constitutes ordinary income to the employee when granted only if the option itself has a readily ascertainable fair market value at that time. If the option does not have a readily ascertainable value when granted, it does not constitute ordinary income at that time.[1] Instead, when the option is exercised, the difference between the value of the stock at exercise[2] and the option price constitutes ordinary income to the employee.

An employer who granted a stock option generally is allowed a business expense deduction equal to the amount includible in the employee's income in its corresponding taxable year (sec. 83(h)).

In addition, present law provides for "incentive stock options", under which there are no tax consequences when the option is granted or, except for the alternative minimum tax, when the option is exercised, and the employee generally is taxed at capital gains rates when the stock received on exercise of the option is sold. No business expense deduction is allowed to the employer with respect to an incentive stock option (sec. 421(a)).

Explanation of the Bill.—The bill provides that an individual may defer the amount otherwise includible in income (under section 83(a)) upon the exercise of an employee stock option until the individual disposes of the stock. The employer's deduction will be deferred until the amount is included in the employee's income. For this provision to apply, the employer and employee must make a joint election in accordance with Treasury regulations. The amount included in ordinary income upon disposition of the stock will not be affected by subsequent changes in the value of the stock. The amount so included will be added to the basis of the stock for purposes of determining gain or loss from the disposition of the stock. A disposition includes a sale, exchange, gift, transfer by reason of death[3] or other transfer of title other than certain tax-free exchanges or pledges.

In order to be eligible to elect the special treatment, the individual, at the time the option is granted, must be an employee either of the company granting the option, a parent or subsidiary of that corporation, or a corporation (or parent or subsidiary of that corporation) which has assumed the option of another corporation as a result of a corporate reorganization, liquidation, etc.

For an option to qualify for the special treatment an option must meet the following conditions:

(1) The option is not an incentive stock option (sec. 422A) and is not an option granted pursuant to an employee stock purchase plan (sec. 423).

(2) The option by its terms requires that stock certificates issued upon exercise of the option be retained by the corporation or its agent for the benefit of the employee, or requires the use of restrictive legends or stop-transfer instruction with respect to the stock certificates. An option meets this requirement if the terms of the option require that any stock certificate of a corporation issued upon exercise of the option indicates on the face of the certificate that transfer of the stock is subject to the provision of notice to the corporation of the transfer.

(3) The corporation must notify the Internal Revenue Service of the sale of the option stock.

Effective Date.—The bill would apply to options exercised after date of enactment.

Revenue Effect.—The bill would reduce fiscal year budget receipts by a negligible amount in 1984 and 1985, $12 million in 1986, $18 million in 1987, $7 million in 1988, and by a negligible amount in 1989.

Other Congressional Action.—The Senate Finance Committee adopted, as part of its deficit reduction provisions approved on March 21, 1984, a similar provision, but limited its application to options meeting a number of restrictive conditions, including certain nondiscrimination rules.

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[1] Section 83 does not apply to the transfer of an option without a readily ascertainable fair market value (sec. 83(e)(3)). Treas. Reg. S1.83-7(a) implies that no income is realized upon grant of such an option.

[2] For this purpose, the value of the stock is determined without regard to restrictions other than restrictions which by their terms will never lapse.

[3] The income will be included on the decedent's last return.

STATEMENT OF HON. CARROLL A. CAMPBELL, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. Chairman, I want to thank you for this opportunity to testify on the Employee Stock Ownership Assistance Act. As the lead cosponsor of this legislation, I am pleased that this hearing is being held. I also want to thank my colleague from New Jersey, Mr. Guarini, for sponsoring this legislation and for his tireless effort on behalf of this issue.

Under current law, employees are often forced to sell their company's stock in order to raise the cash necessary to pay the tax resulting from the exercise of certain stock options. When a stock option is exercised, the difference between the value of the stock at the exercise date and the option price constitutes ordinary income to the employee. As a result of such tax treatment, the employee is placed in the untenable position of having to pay income tax at a time when there has been no receipt of cash since only securities representing the employee's investment in his company have been received. The company, on the other hand, is generally allowed a tax deduction equal to the amount of income recognized by the employee.

H.R. 4114 would rectify this situation by deferring the resulting tax, and the corresponding deduction by companies, until the employee disposes of the stock. This proposal removes the cash impediment to exercise stock options and fulfills the basic purpose of granting stock options—which is to encourage employees to acquire an interest in their company in order to increase their commitment, productivity, and stake in the companies' long-term growth.

I want to point out several changes made in the Senate bill that are not incorporated in H.R. 4114, but which we support. First of all, a $100,000 per year cap on income that could be deferred from taxation was implemented. A person could exercise more of his options, but could not defer any more tax. Second, a non-transfer rule was adopted, which would disallow any employee from transferring options. Third, a top-heavy rule was adopted, which disallows highly compensated employees from holding more than 60% of the options. Fourth, this provision would fall under the individual minimum tax, and fifth, the Senate version also requires sequential exercise.

Mr. Chairman, precedent exists in present tax law for deferring recognition of income in many transactions until cash or its equivalent is received. Given the advantages and fairness of this legislation, and it's incentives, I am hopeful that my colleagues will recommend passage of H.R. 4114, and I thank the Subcommittee for its consideration.

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98TH CONGRESS
1ST SESSION

H. R. 4357

To amend the Internal Revenue Code of 1954 to ensure stockholder protection with respect to the treatment of amounts received in certain corporate acquisitions, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 10, 1983

Mr. STARK introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to ensure stockholder protection with respect to the treatment of amounts received in certain corporate acquisitions, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) part IV of subchapter P of chapter 1 of the Internal Revenue Code of 1954 (relating to special rules for determining capital gains and losses) is amended by adding at the end thereof the following new section:

"SEC. 1257. TREATMENT OF AMOUNTS RECEIVED BY CERTAIN SHAREHOLDERS IN CORPORATE ACQUISITIONS.

"(a) GENERAL RULE.—If—

"(1) the consideration per share of stock in any corporation to be received by any 1-percent shareholder in any transaction (or series of transactions), exceeds

"(2) the otherwise prevailing market price for such stock (as of the time the transaction is entered into),

notwithstanding any other provision of this subtitle, any gain realized by such shareholder from such transaction (or series of transactions) shall be recognized and included in gross income as ordinary income.

"(b) DISALLOWANCE OF DEDUCTIONS ATTRIBUTABLE TO TRANSACTION.—No amount otherwise allowable as a deduction under this chapter to the corporation referred to in subsection (a) shall be allowed as a deduction to the extent that such amount is attributable to the transaction (or series of transactions) referred to in subsection (a).

"(c) TREATMENT OF CERTAIN AMOUNTS PAYABLE TO MANAGEMENT.—

"(1) IN GENERAL.—In the case of a management protection agreement—

"(A) no deduction shall be allowed under this chapter for any amount paid or incurred (or property transferred) pursuant to such agreement, and

"(B) the present value of the aggregate amount (including property) to be received under such agreement by any person shall be included in the gross income of such person as ordinary income for his taxable year in which the employment relationship is terminated.

"(2) MANAGEMENT PROTECTION AGREEMENT.—For purposes of this subsection—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'management protection agreement' means any agreement to make one or more payments (or transfers of property) to an employee of a corporation if such employee's employment with the corporation is terminated within a specified period after a change (of a kind specified in the agreement) in the ownership or control of the corporation.

"(B) EXCEPTION FOR NONDISCRIMINATORY AGREEMENTS.—The term 'management protection agreement' does include any agreement if the benefits provided under such agreement do not discriminate in favor of employees who are officers, shareholders, or highly compensated.

"(d) DEFINITIONS.—For purposes of this section—

"(1) CONSIDERATION.—The term 'consideration' means—

"(A) the fair market of the stock, securities, or other property, and

"(B) the amount of cash,

to be received in the transaction (or series of transactions).

"(2) 1-PERCENT SHAREHOLDER.—The term '1-percent shareholder' means any person who owns (directly or through the application of section 318) stock possessing 1 percent or more of the total combined voting power of all classes of stock entitled to vote."

(b) The table of sections for such part IV is amended by adding at the end thereof the following new item:

"Sec. 1257. Treatment of amounts received by certain shareholders in certain corporate acquisitions."

(c) The amendments made by this section shall apply to transactions after November 10, 1983, in taxable years ending after such date.

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Description of H.R. 4357

PRESENT LAW

In general.—When one corporation acquires the stock or assets of another corporation, the consideration involved usually is received by the shareholders of the acquired corporation in exchange for their stock in the acquired corporation. If that consideration is cash or certain other property, the shareholders will generally recognize gain (or loss) measured by the difference between the value of the consideration received at the time they receive it and their basis in the stock exchanged. Such gain (or loss) is usually capital gain (or loss). Capital gain is taxed at a lower rate than ordinary income.

The acquisition transaction may be structured as an installment sale. In an installment sale, the acquiring corporation uses its own installment obligations as the consideration. In an installment sale, gain realized by a shareholder is generally not recognized at the time of the transaction. Rather, it is recognized only as payments under the installment obligations are made. Such payments are prorated between gain realized and the shareholder's basis in the stock exchanged. When the gain is recognized, it is generally capital in character.

The acquisition transaction may also be structured as a reorganization. In a reorganization, the acquiring company generally issues shares of its stock to shareholders of the acquired corporation. Gain realized by such shareholders is generally not taxable. Rather, they take a basis in the stock received equal to their basis in the stock of the acquired corporation surrendered. As a result, gain realized in the reorganization will be taxed only when and if the stock received is subsequently sold or exchanged in a taxable transaction.

Present law permits corporations to deduct all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Such expenses include reasonable salaries or other compensation for personal services actually rendered. They can also include severance, or termination, pay. Generally, unfunded compensation, including severance or termination pay, is includible as ordinary income by the recipient. However, it is generally not includible until it is received.

Corporate acquisition considerations.—For a variety of reasons, in recent years there has been a large increase in corporate acquisition activity. Under Federal and State securities law and in accordance with sound acquisition practices, a corporation desiring to acquire another corporation will often seek the blessing of the management and, perhaps, large shareholders of the target corporation for the offer proposed to be made before it is made. Occasionally, in order to obtain that blessing, the potential acquiring corporation will make arrangements with key management and large shareholders of the target (often the same persons) pursuant to which special additional payments will be made to them. Such special payments may run afoul of applicable securities laws because they can result in unwarranted special treatment for certain persons. Furthermore, from a tax perspective, such payments, while they may be cast as payments for stock, may have a significant compensatory component.

In other situations, the potential acquired corporation may resist being taken over and seek to put into place certain defense mechanisms. One currently popular defense mechanism is the "golden parachute" contract or management protection agreement. Under a typical golden parachute contract, a corporation will contract with key individuals, agreeing to pay them large sums of money if it is successfully taken over and the employment of such individuals is terminated. One goal of such a contract is to make hostile takeover more expensive, and therefore less attractive, for a would-be acquiring corporation. If payments are made under such a contract, the corporation will attempt to deduct them. Under present law, the deductibility of such payment may, in particular cases, be unclear. In any event, many have argued that golden parachute contracts are not in the best interests of the corporation's share-holders generally and ought to be discouraged. Among other things, such contracts may serve to entrench existing management by inhibiting a takeover and to provide a windfall to certain individuals if the defense stragey is unsuccessful.

EXPLANATION OF THE BILL

The bill would provide special rules in the case of one percent or larger shareholders for whom special arrangements are made in the context of an acquisition. The bill would also impose special rules with respect to certain management protection agreements.

Under the bill, one percent or larger shareholders of a corporation who receive for their stock more than the prevailing market price for stock of such corporation at the time of the transaction would be required to include all their gain in income as ordinary income. Furthermore, that income would be includible at the time of the transaction. Finally, that income would be includible notwithstanding any other provisions (including the installment sale provisions and the reorganization provisions) of the Code.

For these purposes, a one percent shareholder is any person who owns (directly or after application of the attribution rules of section 318) one percent or more of the total combined voting power of all classes of stock entitled to vote of a corporation.

No deduction would be allowable to the corporation for any amount paid or incurred in connection with a transaction of the type referred to above.

The bill would also provide that no deduction is to be allowed with respect to amounts paid or accrued under management protection agreements. Furthermore, the present value of all amounts to be received under management protection agreements would be includible in gross income, as ordinary income, by the individual involved at the time his or her employment is terminated, regardless of when those amounts are to be received.

For purposes of these rules, a management protection agreement is any agreement pursuant to which payments are to be made to an employee of a corporation if such employee's employment is terminated within a specified period of time after a change in the ownership or control of the corporation. However, a management protection agreement does not include any agreement that does not discriminate in favor of employees who are officers, shareholders, or highly compensated persons.

EFFECTIVE DATE

The bill would be effective with respect to transactions entered into after November 10, 1983.

REVENUE EFFECT

The bill would increase fiscal year budget receipts by less than $10 million annually.

OTHER CONGRESSIONAL ACTION

The Senate Finance Committee adopted, as part of its deficit reduction provisions approved on March 21, 1984, certain provisions regarding golden parachute contracts, as specifically defined.

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98TH CONGRESS
2D SESSION

H. R. 5028

To amend the Internal Revenue Code of 1954 to make permanent the exclusion from gross income for amounts received under qualified group legal services plans.

IN THE HOUSE OF REPRESENTATIVES

MARCH 6, 1984

Mr. BIAGGI introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to make permanent the exclusion from gross income for amounts received under qualified group legal services plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (e) of section 120 of the Internal Revenue Code of 1954 (relating to termination date for exclusion for amounts received under qualified group legal services plans) is hereby repealed.

DESCRIPTION OF H.R. 5028 AND H.R. 5361

PRESENT LAW

In general.—Under present law, amounts contributed by an employer to a qualified group legal services plan for employees (or their spouses or dependents) are excluded from an employee's gross income for income tax purposes (sec. 120) and from wages for social security and unemployment insurance tax purposes (secs. 3121(a)(17), 3306(b)(12)). The exclusion also applies to any services received by an employee or any amounts paid to an employee under such a plan as reimbursement for legal services for the employee (or the employee's spouse or dependents).

In order to be a qualified plan under which employees are entitled to tax-free benefits, a group legal services plan must fulfill several requirements with regard to its provisions, the employer, and the covered employees.

Legal services.—A qualified group legal services plan must be a separate written plan of an employer for the exclusive benefit of employees or their spouses or dependents. The plan must supply the employees, their spouses, and dependents with specified benefits consisting of personal (i.e., nonbusiness) legal services through prepayment of, or provison in advance for, all or part of an employee's, or an employee's spouse, or dependent's legal fees.

Present law also provides that amounts contributed by employers under a qualified group legal services plan may be paid only (1) to insurance companies or to organizations or persons that provide personal legal services or indemnification against the cost of personal legal services, in exchange for a prepayment or a payment of a premium; (2) to organizations exempt from taxation as organizations described in section 501(c)(20) (see below for description); (3) to organizations described in section 501(c) that are permitted to receive employer contributions for one or more qualified groups legal services plans, provided the organizations pay or credit the employer contributions to another organization that is described in section 501(c)(20); (4) as prepayments to providers of legal services under the plan; or (5) to a combination of the four permissible types of payment arrangements.

Group legal services organization.—Present law also provides that an organization or trust created or organized in the United States whose exclusive function is to form part of a qualified group legal services plan under section 120 is exempt from income tax (sec. 501(c)(20)). Such a trust is subject to the rules generally governing organizations described in section 501(c), including the taxation of any unrelated business income. An exempt organization or trust which receives employer contributions for a group legal services plan because of section 120(c)(5)(C) is not prevented from qualifying for exemption under section 501(c)(20) merely because it provides legal services or indemnification for legal services unassociated with a qualified group legal services plan.

Nondiscrimination.—In order to be a qualified plan, a group legal services plan must also meet requirements with respect to nondiscrimination in contributions or benefits and in eligibility for enrollment.

Present law requires that the contributions paid by an employer and the benefits provided under a plan may not discriminate in favor of employees who are officers, shareholders, self-employed individuals, or highly compensated. The plan must benefit employees who qualify under a classification which the employer sets up and which the Internal Revenue Service determines does not discriminate in favor of employees who are officers, shareholders, self-employed individuals, or highly compensated. However, in determining whether a classification is discriminatory, the employer may exclude from the calculations those employees who are members of a collective bargaining unit if there is evidence that group legal services plan benefits were the subject of good faith bargaining between representatives of that group and the employer.

A limit is placed on the proportion of the amounts contributed under the plan that can be applied for employees who own more than five percent of the stock or of the capital or profits interest in the employer corporation or unincorporated trade or business. The aggregate of the contributions for those employees or their spouses and dependents must not be more than 25 percent of the total contributions.

Other rules.—Under present law, in order to be treated as a qualified group level services plan, the plan must notify the Internal Revenue Service that it is applying for recognition of this qualified status. If the plan fails to notify the IRS by the time prescribed in Treasury regulations, then the plan cannot be regarded as a qualified plan for any period before it in fact gave notice.

An individual who qualifies as an employee within the definition of Code section 401(c)(1) is also an employee for purposes of these group legal services provisions.

This means that, in general, the term employee includes self-employed individuals who have earned income for a taxable year, as well as individuals who would have earned income except that their trades or businesses did not have net profits for a taxable year. An individual who owns the entire interest in an unincorporated trade or business is treated as his or her own employer. A partnership is considered the employer of each partner who is also an employee of the partnership.

Requirement for report from executive agencies.—The Tax Reform Act of 1976 (sec. 2134(d)) required the Secretary of the Treasury and Secretary of Labor to submit to the President and the Congress a report on the desirability and feasibility of continuing the exclusion from income of prepaid group legal services benefits. The report was required to be submitted by December 31, 1980.

The report described above has not yet been submitted to the Congress.

Termination.—The present-law exclusion for prepaid legal services and the tax exemption for group legal services organizations are scheduled to expire for taxable years beginning after December 31, 1984.

EXPLANATION OF THE BILLS

H.R. 5361.—The bill would extend, to be applicable to taxable years beginning before January 1, 1990, the exclusion from gross income and wages for payments to or under a qualified group legal services plan and the tax-exempt status of group legal services organizations.

H.R. 5028.—The bill would make permanent the exclusion from gross income and wages for payments to or under a qualified group legal services plan and the tax-exempt status of group legal services organizations.

EFFECTIVE DATE

The bills would be effective on the date of enactment.

REVENUE EFFECT

Either bill would reduce fiscal year budget receipts by $32 million in 1985, $48 million in 1986, $52 million in 1987, $56 million in 1988, and $60 million in 1989.

STATEMENT OF THE ALASKA TEAMSTER-EMPLOYER PREPARED LEGAL SERVICES TRUST, PHIL REECER, ADMINISTRATOR

Mr. Chairman, on behalf of the Alaska Teamster-Employer Prepaid Legal Services Trust and myself as Administrator, I urge your support for H.R. 5028, legislation which would make permanent those provisions of the Internal Revenue Code which have enabled legal service plans to become so successful in the past decade. These provisions, codified at IRC § 120, exclude from an individual's gross income amounts which are paid into legal service plans.

Congress initially addressed the tax status of contributions to these plans during the consideration of the Tax Reform Act of 1976. The legislative history of this Act indicates that, "it was appropriate to provide a tax incentive to promote prepaid legal service plans." This action was taken in response to the efforts of a unique coalition comprised of unions, consumer groups, bar associations and insurance companies. The Act excluded from an employees' income the amounts contributed by an employer to a qualified group legal services plan for employees as well as any services received by an employee or any amounts paid to an employee under such a plan as reimbursement for legal services for the employee, his spouse, or his dependents. Included in the Act was a termination date for these provisions of December 31, 1981.

Throughout the late 1970s, the legal service plan concept took root. Congress obviously felt that these provisions were successful enough to warrant their extension and in 1981 a 3-year extension was included in the Economic Recovery Tax Act. This resulted in a new expiration date of December 31, 1984 for the provision. With that date rapidly approaching, and with the legislative schedule certain to become crowded, it is imperative that timely action be taken to insure the stability and continued existence of these plans.

Since its inception in 1976, the prepaid legal fringe benefit has been a very worthwhile provision of Teamster collective bargaining agreements for our 10,000 members. Unfortunately, this benefit will not survive unless it continues as a tax free beneft to our members and as a tax deductible contribution for our employers.

The benefits which our members derive from this program are substantial. The advance arrangements concerning the choice of an attorney as well as the attorney's fee create an atmosphere in which our members are confortable and confident in confronting their legal problems. The result is that our members not only contact lawyers more often, but tend to do so at an earlier point in the course of a problem. In the long run, matters are handled at a lower cost and in a fashion which minimizes disputes and litigation. These employees, I believe, are more efficient and productive since they know their legal affairs are going to be dealt with promptly and professionally without undue cost.

The Alaska Teamsters Legal Services Plan has enabled its membership to obtain quality legal service at a low cost. This is especially important to our members, most of whom are middle income wage earners. As the legislative history of the 1976 Tax Reform Act indicates low income persons have access to publicly supported legal aid services while individuals with higher incomes can generally afford their own legal expenses. The tax provisions which provide for the tax exempt status which currently extend to qualified legal service plans are essential to insuring that middle income wage earners are granted adequate and competent legal counsel.

As I indicated earlier, there is a unique coalition supporting legal service plans. The existence of this coalition is evidence of the fact that we have a successful program which should not be terminated. Proof of this success is demonstrated in the increase of legal service plans. The National Resources Center for Consumers of Legal Services estimates that over 700 plans exist today compared to 75 in 1975. These 700 plans cover approximately 2 million employees and their famllies. These 2 million employees receive legal assistance for less than $100 annually per capita. This results in a very small revenue loss to the Federal Treasury. For 1983, the Joint Taxation Committee estimated this loss at $25 million.

The provision of legal services to 2 million individuals and their families at a cost of $25 million has to be one of the most cost effective programs that exist today. It is one which should be continued.

On behalf of Alaska Teamster Employer Prepaid Legal Services Trust, headquartered in Anchorage, I urge the Committee to move quickly on legislation which would assure the tax status of legal service plans. The extension of section 120 of the Code as provided for in H.R. 5028 will ensure that quality legal service will be available to the working men and women of this nation.

98TH CONGRESS
2D SESSION

H. R. 5361

To extend for five years a tax provision to encourage employers to provide legal services for their employees.

IN THE HOUSE OF REPRESENTATIVES

APRIL 4, 1984

Mr. STARK introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To extend for five years a tax provision to encourage employers to provide legal services for their employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 120 of the Internal Revenue Code of 1954 is amended by striking the phrase "December 31, 1984", and inserting in lieu thereof the words "December 31, 1989".

STATEMENT OF THE AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, AFL-CIO

This statement is submitted on behalf of the American Federation of State, County and Municipal Employees (AFSCME), a labor union representing more than a million public employees nationwide. We appreciate the opportunity to present our views on H.R. 5361, a bill that would extend Section 120 of the Internal Revenue Code for five years.

We would like to commend the Chairman for introducing this important legislation and for holding a hearing focusing on the exclusion for group legal service plans. AFSCME believes that this bill would encourage the growth and development of group legal services, and we strongly urge the Committee to give it favorable consideration. Furthermore, we hope the Committee will give serious consideration to making Section 120 permanent to encourage employers to provide legal services for their employees.

AFSCME has long supported the concept of group legal service plans. Working men and women of low and middle income have long been priced out of the market of obtaining quality legal care. Traditionally, legal aid has only been available to the top and bottom of the economic spectrum in our society. The upper income brackets can afford to hire a private lawyer, while the lowest can obtain help through legal aid offices. America's middle class has been forced to fend for themselves.

However, in 1976, a major step was taken to assure that quality legal aid would be made available to all Americans. At that time, Section 120 was added to the Internal Revenue Code, authorizing an exclusion for employer contributions to and services provided under qualified group legal service plans.

Since that time, AFSCME has helped develop group legal service plans in various jurisdictions across the country, including Columbus, Ohio, Philadelphia, Austin, Suffolk County, New York and New York City.

We believe the New York City group legal plan deserves special mention. AFSCME's District Council 37 Municipal Employees Legal Services Plan (MELS) was one of the first and largest employer-funded plans. It has been in operation since 1977. It serves 100,000 city workers, 15,000 retirees and their families. Its members, employees of the City of New York, work in blue collar, white collar and professional jobs. Their salaries range from $9,000 to $30,000, with a majority concentrated in the lower end. The situations where they need legal aid include domestic relations and other family law matters, consumer and debtor matters, and real estate closings.

Nearly 10,000 persons use MELS every year. Full legal services, including representation in court, are provided free of charge to the covered person. MELS hires its own staff; 60 lawyers and 90 support staff, made up of paraprofessionals, social workers and clericals.

Where we have them, group legal service plans have proven to be an important benefit for our members. It allows our middle and lower income membership ready access to competent legal advice, which in many cases will avoid costly litigation down the road.

AFSCME strongly supports the continued growth of group legal service plans and we believe the only avenue for this growth is Section 120 of the Internal Revenue Code.

Section 120 is scheduled to expire on December 21, 1984. If it is not extended, current plans will be jeopardized and the formation of new plans will be put in serious doubt.

Making Section 120 permanent will not, we believe, cause severe damage to the federal budget. The Joint Committee on Taxation has estimated that the tax expenditure associated with Section 120 amounted to only $20 million in 1982. Even with continued growth of the plans, because of the low cost of such plans, the future tax expenditure will be minimal.

Once again, we want to commend you, Mr. Chairman, for your leadership in this area. We strongly support the passage of H.R. 5361 and urge the Committee's swift consideration.

Thank you for the opportunity to present this statement. We stand ready to provide any additional information or assistance on this matter as the Committee may require.

BOSTON TEACHERS UNION,
PREPAID LEGAL SERVICES FUND,
Boston, MA, April 18, 1984.

U.S. HOUSE OF REPRESENTATIVES,
Committee on Ways and Means,
Longworth House Office Building, Washington, DC.

DEAR MEMBERS OF CONGRESS: I am writing in behalf of the 12,069 Boston Public School Teachers and eligible dependents covered by the Boston Teachers Union Prepaid Legal Services Plan, a group legal services plan qualified under Section 120 of the Internal Revenue Code. I write to urge the Ways and Means Committee to recommend approval of H.R. 5361, a bill to extend that section of the Code for five years.

The existence of Section 120 has made it possible for our Covered Teachers and dependents to obtain high quality legal services in time to avoid or resolve problems which might have required expensive litigation if action were delayed. This preventive aspect of the prepaid legal plans makes them especially beneficial in terms of controlling costs, reducing court backlogs, and eliminating individual mental and emotional strain.

In our geographic area of service, which includes parts of each of the New England States, our plan offers, as legal plans in general do, a group approach to satisfying a common need. It offers important legal protection to some of those citizens who are neither wealthy enough to afford legal services on their own in many instances where such services are advisable, nor poor enough to qualify for the free legal services available to those who meet various low income criteria.

The drafting of wills, representation during the purchase or sale of permanent residences, and assistance with domestic relations problems are just a few of the covered services which have been so well received by our eligible members. Evidence of the value of this benefit is the fact that, in the 29 months of existence of the Boston Teachers Union Prepaid Legal Service Plan, it has provided attorney's services for more than 1800 legal matters. This benefit certainly deserves equal tax treatment with other statutory fringe benefits and I respectfully ask the House Ways and Means Committee to do its part to make it so for at least the next five years.

Sincerely,

ERNEST M. THOMAS
Chairman, Board of Trustees.

STATEMENT OF ROBERT A. GEORGINE, PRESIDENT, BUILDING & CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

Mr. Chairman, my name is Robert A. Georgine. I am president of the Building and Construction Trades Department, of the AFL-CIO, which has 15 affiliated member unions representing over 4 million American workers.

The Building and Construction Trades Department wholeheartedly supports a measure to make permanent Section 120 of the Internal Revenue Code, which excludes from the gross income of employees the value of employer contributions to or services provided by a qualified group legal services plan. The Building Trades believes that the bill, similar to the one introduced in the Senate (S. 2080), by Senator Packwood, is essential to insuring the availability of legal services to the American worker. The labor movement joined consumers, the organized bar and the insurance industry in enthusiastically supporting Section 120 in 1976, in 1981, and we do so again. But let's make it permanent this time!

The enactment of Section 120 in 1976 culminated a decade of rapid change in the delivery of legal services to people of moderate means, a change in which building trades unions were deeply involved. Once the Supreme Court had verified the constitutional right of citizens to associate for the purpose of obtaining legal services, some of our unions immediately began testing legal plans. It was a building trades union, the Laborers', who in conjunction with the American Bar Association, set up the first prepaid legal plan in 1971, the Open Panel Shreveport Plan. Another Laborers' International Union local, established in 1973, here in the District of Columbia, the first prepaid plan using fulltime staff lawyers. Local after local established, or seriously considered establishing, its own dues funded plan. In most cases a longer range goal was to convert the plan to employer funding. But until enactment of Section 120, this was not practical. That section gave prepaid legal services a tax status similar to that enjoyed by health care plans and other fringe benefits, and enabled labor unions to negotiate with employers for legal service plans as a fringe benefit.

Since 1976, thousands of plans have been established and thousands more are being considered. Since the 1981 extension, the Sheet Metal Workers, a building trades union, has established a national trust fund for legal services, which more and more of their locals are joining.

Section 120 works. The plans work. They encourage preventive law, reduce the cost of legal services and make them more readily available. The plans have an impressive variety of form, size and focus. They are individually tailored to the needs of each group's members.

Would like to stress one point that may not have been emphasized earlier. That is what the meaning would be if Congress permitted Section 120 to expire. Over the last eleven years Congress three time has acted in support of legal services as a fringe benefit, first by amending the Taft-Hartley Act, second by enacting Section 120, third by extending the section. Now that Congress' earlier actions are having their desired effect, for Congress to let Section 120 expire—and that is what will happen if this Congress does not act—would be tantamount to rejecting equal access to the legal system as a desirable goal.

Is this judgment too strong? I don't think so. With the assistance of Section 120, ten times as many people are now covered by a legal plan as were covered when the section was first enacted in 1976. Costs are stable; revenue loss is minimal; plans are virtually unopposed. Their popularity is soaring. Large plans have recently begun on the assumption that Congress would rely on the wholly positive results of its earlier actions and continue to afford qualified plans fair tax treatment with other statutory fringe benefits. Absent a wholesale revision of the tax code it is difficult to see how Congress could determine to let Section 120 expire unless it had determined that preventive law and equal access to legal service were undersirable.

MIRKIN & GORDON, P.C.,
Great Neck, NY, April 18, 1984.

Re. H.R. 5361.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives,
Longsworth House Office Building, Washington, DC.

DEAR MR. SALMON: I write in support of the above bill to make Section 120 of the Internal Revenue Code permanent.

This firm, and myself in particular, have been part of the prepaid or group legal service movement since before there was a movement as such. As counsel to various public sector unions I was intimately involved in devising and developing comprehensive programs for both inner city memberships and suburban groups as far back as in the early 1970's. From then to now we have participated in the delivery of these programs to upwards of twenty-five thousand union members and their families and therefore have been in an excellent position to evaluate the efficacy of these programs generally and the impact of Section 120 specifically.

Having been counsel to very many union benefit trust funds over the years, I am acutely aware not only of the denotative value that tax exempt status confers on a union trust fund; but, also, that the connotative value of being "tax qualified" is significant. There is no question that this status is viewed by many as one of the government's ways of giving an imprimatur to a movement, a program or an idea. In the case of the group legal movement, I have witnessed (being in a position to closely observe events both before and after the adoption of Section 120) the proper boost it received when Congress initially acted. The continued existence of Section 120 and its enactment as a permanent part of the Country's laws will reinforce that laudatory effect—the continuing impetus to organizations to adopt legal programs covering the middle income and working poor of this nation. Conversely, adverse action would have the effect of going well beyond simply a congressional tax law action. It would have a ripple impact for some time to come. Adverse action would not only chill the development of new programs; but, it may very well force the retrenchment of existing ones.

I have made the foregoing point specifically so as to add to the dialgoue and not replicate testimony which will be ably delivered by Mr. William Bolger and others of the National Resource Center for Consumers of Legal Services upon whose Board of Directors I proudly serve as an executive committee member.

Nevertheless, I am in the position to assure the committee that I, and certain of my clients, would, if requested, be happy to come forward with extensive and wide ranging testimony which would document and dramatize the social utility and beneficial impact of these programs on thousands of families (we currently service five large comprehensive programs), their effectiveness, and their extremely and consistently high quality. Accordingly, please advise whether you would wish anything further from the undersigned.

Below are listed some of the programs with which we are association:

Social Service Employees Union Local 371, AFSCME (New York City—all five boroughs).

Westchester-Putnam Teachers Legal Services Fund (Westchester and Putnam Counties): Dobbs Ferry United Teachers; Yorktown Congress of Teachers; Greenburgh Teachers Federation; Brewster Teachers Association; Mount Vernon Federation of Teachers; Mahopac Teachers Association;

Communication Workers of America Local 1180 (New York City—all five boroughs);

Service Employees International Union Local 32-E (Bronx and Westchester Counties);

Suffolk County Superior Officers Association (Suffolk County).

Very truly yours,

STEPHEN F. GORDON.

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